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

MEMBERS' HANDBOOK

Update No. 147

(Issued 7 May 2014)

Handbook Improvements only

Document Reference and Title	*Instructions*	*Explanations*

VOLUME II

Contents of Volume II	Insert the revised pages i - iv. Discard the replaced pages i - iv.	Revised contents pages

Amendments to the following Standards, Basis for Conclusions and Implementation Guidance were previously set out in the Appendix to the Standards as they were not yet effective. The Institute has taken this opportunity to incorporate the amendments applicable on 1 January 2013 in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

HONG KONG ACCOUNTING STANDARDS (HKAS)

HKAS 1 *Presentation of Financial Statements*	Replace the Standard, Basis for Conclusions and Implementation Guidance with revised Standard, Basis for Conclusions and Implementation Guidance	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - HKAS 19 *Employee Benefits* (2011) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 12 *Disclosure of Interests in Other Entities* - HKFRS 13 *Fair Value Measurement* - *Annual Improvements 2009-2011 Cycle*

HKAS 12 *Income Taxes*	Replace the cover page and pages 2-3, 5, 8, 14-15, 18, 21-22, 27, 31, 33, 35-36 and 63 with revised cover page and pages 2-3, 5, 8, 14-15, 18, 21-22, 27, 31, 33, 35-36 and 63	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - HKFRS 11 *Joint Arrangements*
HKAS 18 *Revenue*	Replace the Standard with revised Standard	Amendments due to - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*
HKAS 21 *The Effects of Changes in Foreign Exchange Rates*	Replace the Standard and Basis for Conclusions with revised Standard and Basis for Conclusions	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*
HKAS 32 *Financial Instruments: Presentation*	Replace the Standard and Basis for Conclusions with revised Standard and Basis for Conclusions	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - *Disclosures-Offsetting Financial Assets and Financial Liabilities* (Amendment to HKFRS 7) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement* - *Annual Improvements 2009-2011 Cycle*

HKAS 33 *Earnings per Share*	Replace the cover page and pages 2-4, 6-8, 13-14, 18, 20, 22 and 24 with revised cover page and pages 2-4, 6-8, 13-14, 18, 20, 22 and 24	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

HKFRS 7 *Financial Instruments: Disclosures*	Replace the Standard, Basis for Conclusions and Implementation Guidance with revised Standard, Basis for Conclusions and Implementation Guidance	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - *Disclosures- Offsetting Financial Assets and Financial Liabilities* (Amendment to HKFRS 7) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*

HONG KONG (IFRIC) INTERPRETATIONS (HK(IFRIC)-Int)

HK(IFRIC) - Int 14 *HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*	Replace the Interpretation, Basis for Conclusions and Illustrative Examples with revised Interpretation, Basis for Conclusions and Illustrative Examples	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 13 *Fair Value Measurement*
HK(IFRIC) - Int 16 *Hedges of a Net Investment in a Foreign Operation*	Replace the cover page and pages 2-4 with revised cover page and pages 2-4.	Amendments due to - HKFRS 11 *Joint Arrangements*

HK(IFRIC) - Int 17 *Distributions of Non-cash Assets to Owners*	Replace the Interpretation, Basis for Conclusions and Illustrative Examples with revised Interpretation, Basis for Conclusions and Illustrative Examples	Amendments due to - HKFRS 10 *Consolidated Financial Statements* - HKFRS 13 *Fair Value Measurement*
HK(IFRIC) - Int 19 *Extinguishing Financial Liabilities with Equity Instruments*	Replace the Interpretation and Basis for Conclusions with revised Interpretation and Basis for Conclusions	Amendments due to - HKFRS 13 *Fair Value Measurement*

HONG KONG (SIC) INTERPRETATIONS (HK(SIC)-Int)

HK(SIC) - Int 31 *Revenue – Barter Transactions Involving Advertising Services*	Replace the Interpretation and Basis for Conclusions with revised Interpretation and Basis for Conclusions	Amendments due to - HKFRS 13 *Fair Value Measurement*
HK(SIC) - Int 32 *Intangible Assets – Web Site Costs*	Replace the Interpretation, Basis for Conclusions and Illustrative Examples with revised Interpretation, Basis for Conclusions and Illustrative Examples	Amendments due to - HKFRS 13 *Fair Value Measurement*

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MEMBERS' HANDBOOK
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(Updated to May 2014)

Issue/(Review date)

Note: * *With effect from 24 May 2005, all Interpretations that are developed locally by the Institute are named Hong Kong Interpretations.*

Issue/(Review date)

SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING FRAMEWORK AND FINANCIAL REPORTING STANDARD (SME-FRF & SME-FRS)

ACCOUNTING GUIDELINES (AG)

ACCOUNTING BULLETINS (AB)

HKAS 1 (Revised)
Revised ~~June 2012~~May 2014

Effective for annual periods beginning on or after 1 January 2009

Hong Kong Accounting Standard 1 (Revised)

Presentation of Financial Statements

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

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Hong Kong Accounting Standard 1 *Presentation of Financial Statements* (HKAS 1) is set out in paragraphs 1–140 and Appendix A. All the paragraphs have equal authority. HKAS 1 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting.* HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

This revised Standard was issued in December 2007 and revised in ~~June 2012~~May 2014. It supersedes HKAS 1, issued in 2004, as amended in 2005.

Introduction

IN1 Hong Kong Accounting Standard 1 *Presentation of Financial Statements* (HKAS 1) replaces HKAS 1 *Presentation of Financial Statements* (issued in 2004) as amended in 2005. HKAS 1 sets overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Reasons for revising HKAS 1

IN2 The objective of Hong Kong Institute of Certified Public Accountants (HKICPA) revising HKAS 1 is to maintain international convergence arising from the revision of IAS 1 *Presentation of Financial Statements* by the International Accounting Standards Board (IASB). The HKICPA supported the reasons for revising IAS 1 of the IASB.

The main objective of the IASB in revising IAS 1 was to aggregate information in the financial statements on the basis of shared characteristics. With this in mind, the IASB considered it useful to separate changes in equity (net assets) of an entity during a period arising from transactions with owners in their capacity as owners from other changes in equity. Consequently, the IASB decided that all owner changes in equity should be presented in the statement of changes in equity, separately from non-owner changes in equity.

IN3 In its review, the IASB also considered FASB Statement No. 130 *Reporting Comprehensive Income* (SFAS 130) issued in 1997. The requirements in IAS 1 regarding the presentation of the statement of comprehensive income are similar to those in SFAS 130; however, some differences remain and those are identified in paragraph BC106 of the Basis for Conclusions.

IN4 In addition, the IASB's intention in revising IAS 1 was to improve and reorder sections of IAS 1 to make it easier to read. The IASB's objective was not to reconsider all the requirements of IAS 1.

Main features of HKAS 1

IN5 HKAS 1 affects the presentation of owner changes in equity and of comprehensive income. It does not change the recognition, measurement or disclosure of specific transactions and other events required by other HKFRSs.

IN6 HKAS 1 requires an entity to present, in a statement of changes in equity, all owner changes in equity. All non-owner changes in equity (ie comprehensive income) are required to be presented in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income). Components of comprehensive income are not permitted to be presented in the statement of changes in equity.

IN7 HKAS 1 requires an entity to present a statement of financial position as at the beginning of the earliest comparative period in a complete set of financial statements when the entity applies an accounting policy retrospectively or makes a retrospective restatement, as defined in HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, or when the entity reclassifies items in the financial statements.

IN8 HKAS 1 requires an entity to disclose reclassification adjustments and income tax relating to each component of other comprehensive income. Reclassification adjustments are the amounts reclassified to profit or loss in the current period that were previously recognised in other comprehensive income.

IN9 HKAS 1 requires the presentation of dividends recognised as distributions to owners and related amounts per share in the statement of changes in equity or in the notes. Dividends are distributions to owners in their capacity as owners and the statement of changes in equity presents all owner changes in equity.

Changes from previous requirements

IN10 The main changes from the previous version of HKAS 1 are described below.

A complete set of financial statements

IN11 The previous version of HKAS 1 used the titles 'balance sheet' and 'cash flow statement' to describe two of the statements within a complete set of financial statements. HKAS 1 uses 'statement of financial position' and 'statement of cash flows' for those statements. The new titles reflect more closely the function of those statements, as described in the *Framework*[*] (see paragraphs BC14–BC21 of the Basis for Conclusions).

IN12 HKAS 1 requires an entity to disclose comparative information in respect of the previous period, ie to disclose as a minimum two of each of the statements and related notes. It introduces a requirement to include in a complete set of financial statements a statement of financial position as at the beginning of the earliest comparative period whenever the entity retrospectively applies an accounting policy or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. The purpose is to provide information that is useful in analysing an entity's financial statements (see paragraphs BC31 and BC32 of the Basis for Conclusions).

Reporting owner changes in equity and comprehensive income

IN13 The previous version of HKAS 1 required the presentation of an income statement that included items of income and expense recognised in profit or loss. It required items of income and expense not recognised in profit or loss to be presented in the statement of changes in equity, together with owner changes in equity. It also labelled the statement of changes in equity comprising profit or loss, other items of income and expense and the effects of changes in accounting policies and correction of errors as 'statement of recognised income and expense'. HKAS 1 now requires:

(a) all changes in equity arising from transactions with owners in their capacity as owners (ie owner changes in equity) to be presented separately from non-owner changes in equity. An entity is not permitted to present components of comprehensive income (ie non-owner changes in equity) in the statement of changes in equity. The purpose is to provide better information by aggregating items with shared characteristics and separating items with different characteristics (see paragraphs BC37 and BC38 of the Basis for Conclusions).

(b) income and expenses to be presented in one statement (a statement of comprehensive income) or in two statements (a separate income statement and a statement of comprehensive income), separately from owner changes in equity (see paragraphs BC49–BC54 of the Basis for Conclusions).

(c) components of other comprehensive income to be displayed in the statement of comprehensive income.

(d) total comprehensive income to be presented in the financial statements.

[*] In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting.*

Other comprehensive income—reclassification adjustments and related tax effects

IN14 HKAS 1 requires an entity to disclose income tax relating to each component of other comprehensive income. The previous version of HKAS 1 did not include such a requirement. The purpose is to provide users with tax information relating to these components because the components often have tax rates different from those applied to profit or loss (see paragraphs BC65–BC68 of the Basis for Conclusions).

IN15 HKAS 1 also requires an entity to disclose reclassification adjustments relating to components of other comprehensive income. Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in previous periods. The purpose is to provide users with information to assess the effect of such reclassifications on profit or loss (see paragraphs BC69–BC73 of the Basis for Conclusions).

Presentation of dividends

IN16 The previous version of HKAS 1 permitted disclosure of the amount of dividends recognised as distributions to equity holders (now referred to as 'owners') and the related amount per share in the income statement, in the statement of changes in equity or in the notes. HKAS 1 requires dividends recognised as distributions to owners and related amounts per share to be presented in the statement of changes in equity or in the notes. The presentation of such disclosures in the statement of comprehensive income is not permitted (see paragraph BC75 of the Basis for Conclusions). The purpose is to ensure that owner changes in equity (in this case, distributions to owners in the form of dividends) are presented separately from non-owner changes in equity (presented in the statement of comprehensive income).

Presentation of items of other comprehensive income

IN17 In July 2011 the HKICPA issued *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1). The amendments improved the consistency and clarity of the presentation of items of other comprehensive income (OCI). The amendments also highlighted the importance on presenting profit or loss and OCI together and with equal prominence. As explained in paragraph IN13, in 2007 HKAS 1 was amended to require profit or loss and OCI to be presented together. The amendments issued in July 2011 retained that requirement, but focused on improving how items of OCI are presented.

IN18 The main change resulting from the amendments was a requirement for entities to group items presented in OCI on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments did not address which items are presented in OCI.

IN19 The amendments did not change the option to present items of OCI either before tax or net of tax. However, if the items are presented before tax then the tax related to each of the two groups of OCI items (those that might be reclassified and those that will not be reclassified) must be shown separately.

Hong Kong Accounting Standard 1
Presentation of Financial Statements

Objective

1 This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Scope

2 An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with Hong Kong Financial Reporting Standards (HKFRSs).

3 Other HKFRSs set out the recognition, measurement and disclosure requirements for specific transactions and other events.

4 This Standard does not apply to the structure and content of condensed interim financial statements prepared in accordance with HKAS 34 *Interim Financial Reporting*. However, paragraphs 15–35 apply to such financial statements. This Standard applies equally to all entities, including those that present consolidated financial statements in accordance with HKFRS 10 *Consolidated Financial Statements* and those that present separate financial statements ~~as defined~~ in accordance with HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*.

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

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

Definitions

7 The following terms are used in this Standard with the meanings specified:

General purpose financial statements **(referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.**

Impracticable **Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.**

Hong Kong Financial Reporting Standards (HKFRSs) **are Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). They comprise:**

(a) Hong Kong Financial Reporting Standards;

(b) Hong Kong Accounting Standards; and

(c) Interpretations.

Material **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.**

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* states in paragraph 25[*] that 'users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Notes **contain information in addition to that presented in the statement of financial position, statement(s) of profit or loss and other comprehensive income, ~~separate income statement (if presented),~~ statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.**

Other comprehensive income **comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other HKFRSs.**

The components of other comprehensive income include:

(a) changes in revaluation surplus (see HKAS 16 *Property, Plant and Equipment* and HKAS 38 *Intangible Assets*);

(b) ~~actuarial gains and losses on~~remeasurements of defined benefit plans ~~recognised in accordance with paragraph 93A of~~ (see HKAS 19 *Employee Benefits)*;

(c) gains and losses arising from translating the financial statements of a foreign operation (see HKAS 21 *The Effects of Changes in Foreign Exchange Rates*);

(d) gains and losses on remeasuring available-for-sale financial assets (see HKAS 39 *Financial Instruments: Recognition and Measurement*);

(e) the effective portion of gains and losses on hedging instruments in a cash flow hedge (see HKAS 39).

Owners **are holders of instruments classified as equity.**

Profit or loss **is the total of income less expenses, excluding the components of other comprehensive income.**

Reclassification adjustments **are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.**

[*] In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. Paragraph 25 was superseded by Chapter 3 of the *Conceptual Framework*.

Total comprehensive income **is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.**

Total comprehensive income comprises all components of 'profit or loss' and of 'other comprehensive income'.

8 Although this Standard uses the terms 'other comprehensive income', 'profit or loss' and 'total comprehensive income', an entity may use other terms to describe the totals as long as the meaning is clear. For example, an entity may use the term 'net income' to describe profit or loss.

8A The following terms are described in HKAS 32 *Financial Instruments: Presentation* and are used in this Standard with the meaning specified in HKAS 32:

(a) puttable financial instrument classified as an equity instrument (described in paragraphs 16A and 16B of HKAS 32)

(b) an instrument that imposes on the entity an obligation to deliver to another party a prorata share of the net assets of the entity only on liquidation and is classified as an equity instrument (described in paragraphs 16C and 16D of HKAS 32).

Financial statements

Purpose of financial statements

9 Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's:

(a) assets;

(b) liabilities;

(c) equity;

(d) income and expenses, including gains and losses;

(e) contributions by and distributions to owners in their capacity as owners; and

(f) cash flows.

This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

Complete set of financial statements

10 A complete set of financial statements comprises:

(a) a statement of financial position as at the end of the period;

(b) a statement of profit or loss and other comprehensive income for the period;

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

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

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

(ea) comparative information in respect of the preceding period as specified in paragraphs 38 and 38A; and

(f) a statement of financial position as at the beginning of the ~~earliest comparative~~preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A - 40D.

An entity may use titles for the statements other than those used in this Standard. For example, an entity may use the title 'statement of comprehensive income' instead of 'statement of profit or loss and other comprehensive income'.

10A An entity may present a single statement of profit or loss and other comprehensive income, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section. An entity may present the profit or loss section in a separate statement of profit or loss. If so, the separate statement of profit or loss shall immediately precede the statement presenting comprehensive income, which shall begin with profit or loss.

11 An entity shall present with equal prominence all of the financial statements in a complete set of financial statements.

12 [Deleted]~~As permitted by paragraph 81, an entity may present the components of profit or loss either as part of a single statement of comprehensive income or in a separate income statement. When an income statement is presented it is part of a complete set of financial statements and shall be displayed immediately before the statement of comprehensive income.~~

13 Many entities present, outside the financial statements, a financial review by management that describes and explains the main features of the entity's financial performance and financial position, and the principal uncertainties it faces. Such a report may include a review of:

(a) the main factors and influences determining financial performance, including changes in the environment in which the entity operates, the entity's response to those changes and their effect, and the entity's policy for investment to maintain and enhance financial performance, including its dividend policy;

(b) the entity's sources of funding and its targeted ratio of liabilities to equity; and

(c) the entity's resources not recognised in the statement of financial position in accordance with HKFRSs.

14 Many entities also present, outside the financial statements, reports and statements such as environmental reports and value added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group. Reports and statements presented outside financial statements are outside the scope of HKFRSs.

General features

True and fair view and compliance with HKFRSs

15 **Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. True and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*.[*] The application of HKFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a true and fair view.**

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

17 In virtually all circumstances, an entity achieves a true and fair view by compliance with applicable HKFRSs. A true and fair view also requires an entity:

(a) to select and apply accounting policies in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. HKAS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an HKFRS that specifically applies to an item.

(b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

(c) to provide additional disclosures when compliance with the specific requirements in HKFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

18 **An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.**

19 **In the extremely rare circumstances in which management concludes that compliance with a requirement in an HKFRS would be so misleading that it would conflict with the objective of financial statements set out in the *Framework*, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.**

20 **When an entity departs from a requirement of an HKFRS in accordance with paragraph 19, it shall disclose:**

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

(b) that it has complied with applicable HKFRSs, except that it has departed from a particular requirement to achieve a true and fair view;

[*] Paragraphs 15-24 contain references to the objective of financial statements set out in the *Framework [for the Preparation and Presentation of Financial Statements]*. In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting*, which replaced the objective of financial statements with the objective of general purpose financial reporting: see Chapter 1 of the *Conceptual Framework*.

(c) **the title of the HKFRS from which the entity has departed, the nature of the departure, including the treatment that the HKFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the *Framework*, and the treatment adopted; and**

(d) **for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.**

21 **When an entity has departed from a requirement of an HKFRS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 20(c) and (d).**

22 Paragraph 21 applies, for example, when an entity departed in a prior period from a requirement in an HKFRS for the measurement of assets or liabilities and that departure affects the measurement of changes in assets and liabilities recognised in the current period's financial statements.

23 **In the extremely rare circumstances in which management concludes that compliance with a requirement in an HKFRS would be so misleading that it would conflict with the objective of financial statements set out in the *Framework*, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:**

(a) **the title of the HKFRS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the *Framework*; and**

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

24 For the purpose of paragraphs 19–23, an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events and conditions that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to influence economic decisions made by users of financial statements. When assessing whether complying with a specific requirement in an HKFRS would be so misleading that it would conflict with the objective of financial statements set out in the *Framework*, management considers:

(a) why the objective of financial statements is not achieved in the particular circumstances; and

(b) how the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the *Framework*.

Going concern

25 When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to 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 upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

26 In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Accrual basis of accounting

27 An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

28 When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the *Framework*.[*]

Materiality and aggregation

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

30 Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.

31 An entity need not provide a specific disclosure required by an HKFRS if the information is not material.

Offsetting

32 An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an HKFRS.

[*] replaced by the *Conceptual Framework* in October 2010.

33 An entity reports separately both assets and liabilities, and income and expenses. Offsetting in the ~~statements~~statement(s) of profit or loss and other comprehensive income or financial position ~~or in the separate income statement (if presented)~~, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. Measuring assets net of valuation allowances—for example, obsolescence allowances on inventories and doubtful debts allowances on receivables—is not offsetting.

34 HKAS 18 *Revenue* defines revenue and requires an entity to measure it at the fair value of the consideration received or receivable, taking into account the amount of any trade discounts and volume rebates the entity allows. An entity undertakes, in the course of its ordinary activities, other transactions that do not generate revenue but are incidental to the main revenue-generating activities. An entity presents the results of such transactions, when this presentation reflects the substance of the transaction or other event, by netting any income with related expenses arising on the same transaction. For example:

(a) an entity presents gains and losses on the disposal of non-current assets, including investments and operating assets, by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses; and

(b) an entity may net expenditure related to a provision that is recognised in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and reimbursed under a contractual arrangement with a third party (for example, a supplier's warranty agreement) against the related reimbursement.

35 In addition, an entity presents on a net basis gains and losses arising from a group of similar transactions, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading. However, an entity presents such gains and losses separately if they are material.

Frequency of reporting

36 An entity shall present a complete set of financial statements (including comparative information) at least annually. When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

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

(b) the fact that amounts presented in the financial statements are not entirely comparable.

37. Normally, an entity consistently prepares financial statements for a one-year period. However, for practical reasons, some entities prefer to report, for example, for a 52-week period. This Standard does not preclude this practice.

Comparative information

Minimum comparative information

38 Except when HKFRSs permit or require otherwise, an entity shall ~~disclose~~ present comparative information in respect of the ~~previous~~ preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information ~~when~~ if it is relevant to ~~an~~ understanding ~~of~~ the current period's financial statements.

38A An entity shall present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two separate statements of profit or loss (if presented), two statements of cash flows and two statements of changes in equity, and related notes.

38B In some cases, narrative information provided in the financial statements for the preceding period(s) continues to be relevant in the current period. For example, an entity discloses in the current period details of a legal dispute, the outcome of which was uncertain at the end of the preceding period and is yet to be resolved. Users may benefit from the disclosure of information that the uncertainty existed at the end of the preceding period and from the disclosure of information about the steps that have been taken during the period to resolve the uncertainty.

Additional comparative information

38C An entity may present comparative information in addition to the minimum comparative financial statements required by HKFRSs, as long as that information is prepared in accordance with HKFRSs. This comparative information may consist of one or more statements referred to in paragraph 10, but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

38D For example, an entity may present a third statement of profit or loss and other comprehensive income (thereby presenting the current period, the preceding period and one additional comparative period). However, the entity is not required to present a third statement of financial position, a third statement of cash flows or a third statement of changes in equity (ie an additional financial statement comparative). The entity is required to present, in the notes to the financial statements, the comparative information related to that additional statement of profit or loss and other comprehensive income.

39 [Deleted] ~~An entity disclosing comparative information shall present, as a minimum, two statements of financial position, two of each of the other statements, and related notes. When an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements or when it reclassifies items in its financial statements, it shall present, as a minimum, three statements of financial position, two of each of the other statements, and related notes. An entity presents statements of financial position as at:~~

~~(a) the end of the current period,~~

~~(b) the end of the previous period (which is the same as the beginning of the current period), and~~

~~(c) the beginning of the earliest comparative period.~~

40 [Deleted] ~~In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, an entity discloses in the current period details of a legal dispute whose outcome was uncertain at the end of the immediately preceding reporting period and that is yet to be resolved. Users benefit from information that the uncertainty existed at the end of the immediately preceding reporting period, and about the steps that have been taken during the period to resolve the uncertainty.~~

Change in accounting policy, retrospective restatement or reclassification

40A An entity shall present a third statement of financial position as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:

(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the statement of financial position at the beginning of the preceding period.

40B In the circumstances described in paragraph 40A, an entity shall present three statements of financial position as at:

(a) the end of the current period;

(b) the end of the preceding period; and

(c) the beginning of the preceding period.

40C When an entity is required to present an additional statement of financial position in accordance with paragraph 40A, it must disclose the information required by paragraphs 41–44 and HKAS 8. However, it need not present the related notes to the opening statement of financial position as at the beginning of the preceding period.

40D The date of that opening statement of financial position shall be as at the beginning of the preceding period regardless of whether an entity's financial statements present comparative information for earlier periods (as permitted in paragraph 38C).

41 ~~When the~~ If an entity changes the presentation or classification of items in its financial statements, ~~the entity~~ it shall reclassify comparative amounts unless reclassification is impracticable. When ~~the~~ an entity reclassifies comparative amounts, ~~the entity~~it shall disclose (including as at the beginning of the preceding period):

(a) the nature of the reclassification;

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

(c) the reason for the reclassification.

42 When it is impracticable to reclassify comparative amounts, an entity shall disclose:

(a) the reason for not reclassifying the amounts, and

(b) the nature of the adjustments that would have been made if the amounts had been reclassified.

43 Enhancing the inter-period comparability of information assists users in making economic decisions, especially by allowing the assessment of trends in financial information for predictive purposes. In some circumstances, it is impracticable to reclassify comparative information for a particular prior period to achieve comparability with the current period. For example, an entity may not have collected data in the prior period(s) in a way that allows reclassification, and it may be impracticable to recreate the information.

44 HKAS 8 sets out the adjustments to comparative information required when an entity changes an accounting policy or corrects an error.

Consistency of presentation

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

(a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in HKAS 8; or

(b) an HKFRS requires a change in presentation.

46. For example, a significant acquisition or disposal, or a review of the presentation of the financial statements, might suggest that the financial statements need to be presented differently. An entity changes the presentation of its financial statements only if the changed presentation provides information that is reliable and more relevant to users of the financial statements and the revised structure is likely to continue, so that comparability is not impaired. When making such changes in presentation, an entity reclassifies its comparative information in accordance with paragraphs 41 and 42.

Structure and content

Introduction

47 This Standard requires particular disclosures in the statement of financial position or ~~of~~ the statement(s) of profit of loss and othe comprehensive income, ~~in the separate income statement (if presented),~~ or in the statement of changes in equity and requires disclosure of other line items either in those statements or in the notes. HKAS 7 *Statement of Cash Flows* sets out requirements for the presentation of cash flow information.

48 This Standard sometimes uses the term 'disclosure' in a broad sense, encompassing items presented in the financial statements. Disclosures are also required by other HKFRSs. Unless specified to the contrary elsewhere in this Standard or in another HKFRS, such disclosures may be made in the financial statements.

Identification of the financial statements

49 An entity shall clearly identify the financial statements and distinguish them from other information in the same published document.

50 HKFRSs apply only to financial statements, and not necessarily to other information presented in an annual report, a regulatory filing, or another document. Therefore, it is important that users can distinguish information that is prepared using HKFRSs from other information that may be useful to users but is not the subject of those requirements.

51 An entity shall clearly identify each financial statement and the notes. In addition, an entity shall display the following information prominently, and repeat it when necessary for the information presented to be understandable:

(a) the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period;

(b) whether the financial statements are of an individual entity or a group of entities;

(c) the date of the end of the reporting period or the period covered by the set of financial statements or notes;

(d) the presentation currency, as defined in HKAS 21; and

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

52 An entity meets the requirements in paragraph 51 by presenting appropriate headings for pages, statements, notes, columns and the like. Judgement is required in determining the best way of presenting such information. For example, when an entity presents the financial statements electronically, separate pages are not always used; an entity then presents the above items to ensure that the information included in the financial statements can be understood.

53 An entity often makes financial statements more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the entity discloses the level of rounding and does not omit material information.

Statement of financial position

Information to be presented in the statement of financial position

54 As a minimum, the statement of financial position shall include line items that present the following amounts:

(a) property, plant and equipment;

(b) investment property;

(c) intangible assets;

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

(e) investments accounted for using the equity method;

(f) biological assets;

(g) inventories;

(h) trade and other receivables;

(i) cash and cash equivalents;

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

(k) trade and other payables;

(l) provisions;

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

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

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

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

(q) non-controlling interests, presented within equity; and

(r) issued capital and reserves attributable to owners of the parent.

55 **An entity shall present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.**

56 **When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).**

57 This Standard does not prescribe the order or format in which an entity presents items. Paragraph 54 simply lists items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

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

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

58 An entity makes the judgement about whether to present additional items separately on the basis of an assessment of:

(a) the nature and liquidity of assets;

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

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

59 The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that an entity presents them as separate line items. For example, different classes of property, plant and equipment can be carried at cost or at revalued amounts in accordance with HKAS 16.

Current/non-current distinction

60 **An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 66–76 except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.**

61 **Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:**

(a) **no more than twelve months after the reporting period, and**

(b) **more than twelve months after the reporting period.**

62 When an entity supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities in the statement of financial position provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.

63 For some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is reliable and more relevant than a current/ non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.

64 In applying paragraph 60, an entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and more relevant. The need for a mixed basis of presentation might arise when an entity has diverse operations.

65 Information about expected dates of realisation of assets and liabilities is useful in assessing the liquidity and solvency of an entity. HKFRS 7 *Financial Instruments: Disclosures* requires disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables, and financial liabilities include trade and other payables. Information on the expected date of recovery of non-monetary assets such as inventories and expected date of settlement for liabilities such as provisions is also useful, whether assets and liabilities are classified as current or as non-current. For example, an entity discloses the amount of inventories that are expected to be recovered more than twelve months after the reporting period.

Current assets

66 An entity shall classify an asset as current when:

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

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

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

(d) the asset is cash or a cash equivalent (as defined in HKAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

An entity shall classify all other assets as non-current.

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

68 The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity’s normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading (examples include some financial assets classified as held for trading in accordance with HKAS 39) and the current portion of non-current financial assets.

Current liabilities

69 An entity shall classify a liability as current when:

(a) it expects to settle the liability in its normal operating cycle;

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

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

(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

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

70 Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period. The same normal operating cycle applies to the classification of an entity's assets and liabilities. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

71 Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Examples are some financial liabilities classified as held for trading in accordance with HKAS 39, bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (ie are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period are non-current liabilities, subject to paragraphs 74 and 75.

72 An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

(a) the original term was for a period longer than twelve months, and

(b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are authorised for issue.

73 If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

74 When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

75 However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

76 In respect of loans classified as current liabilities, if the following events occur between the end of the reporting period and the date the financial statements are authorised for issue, those events are disclosed as non-adjusting events in accordance with HKAS 10 *Events after the Reporting Period*:

(a) refinancing on a long-term basis;

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

(c) the granting by the lender of a period of grace to rectify a breach of a long-term loan arrangement ending at least twelve months after the reporting period.

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

77 An entity shall disclose, either in the statement of financial position or in the notes, further subclassifications of the line items presented, classified in a manner appropriate to the entity's operations.

78 The detail provided in subclassifications depends on the requirements of HKFRSs and on the size, nature and function of the amounts involved. An entity also uses the factors set out in paragraph 58 to decide the basis of subclassification. The disclosures vary for each item, for example:

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

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

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

(d) provisions are disaggregated into provisions for employee benefits and other items; and

(e) equity capital and reserves are disaggregated into various classes, such as paid-in capital, share premium and reserves.

79 An entity shall disclose the following, either in the statement of financial position or the statement of changes in equity, or in the notes:

(a) for each class of share capital:

(i) the number of shares authorised;

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

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

(iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;

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

(vi) shares in the entity held by the entity or by its subsidiaries or associates; and

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

(b) a description of the nature and purpose of each reserve within equity.

80 An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 79(a), showing changes during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

80A If an entity has reclassified

(a) a puttable financial instrument classified as an equity instrument, or

(b) an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument

between financial liabilities and equity, it shall disclose the amount reclassified into and out of each category (financial liabilities or equity), and the timing and reason for that reclassification.

Statement of profit or loss and other comprehensive income

81 [Deleted] ~~An entity shall present all items of income and expense recognised in a period:~~

~~(a) in a single statement of comprehensive income, or~~

~~(b) in two statements: a statement displaying components of profit or loss (separate income statement) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income).~~

81A The statement of profit or loss and other comprehensive income (statement of comprehensive income) shall present, in addition to the profit or loss and other comprehensive income sections:

(a) profit or loss;

(b) total other comprehensive income;

(c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.

If an entity presents a separate statement of profit or loss it does not present the profit or loss section in the statement presenting comprehensive income.

81B An entity shall present the following items, in addition to the profit or loss and other comprehensive income sections, as allocation of profit or loss and other comprehensive income for the period:

(a) profit or loss for the period attributable to:

(i) non-controlling interests, and

(ii) owners of the parent.

(b) comprehensive income for the period attributable to:

(i) non-controlling interests, and

(ii) owners of the parent.

If an entity presents profit or loss in a separate statement it shall present (a) in that statement.

Information to be presented in the ~~statement of comprehensive income~~ profit or loss section or the statement of profit or loss

Information to be presented in the profit or loss section or the statement of profit or loss ~~statement of comprehensive income~~

82 ~~As a minimum~~In addition to items required by other HKFRSs, the profit or loss section or the statement of ~~comprehensive income~~profit or loss shall include line items that present the following amounts for the period:

(a) revenue;

(b) finance costs;

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

(d) tax expense;

(e) [deleted]~~a single amount comprising the total of:~~

~~(i) the post-tax profit or loss of discontinued operations and~~

~~(ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation;~~

(ea) a single amount for the total of discontinued operations (see HKFRS 5).

(f)-(i) [deleted]

~~(f) profit or loss;~~

~~(g) each component of other comprehensive income classified by nature (excluding amounts in (h));~~

~~(h) share of the other comprehensive income of associates and joint ventures accounted for using the equity method; and~~

~~(i) total comprehensive income.~~

Information to be presented in the other comprehensive income section

82A The other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other HKFRSs:

(a) will not be reclassified subsequently to profit or loss; and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

83 [Deleted]~~An entity shall disclose the following items in the statement of comprehensive income as allocations for the period:~~

~~(a) profit or loss for the period attributable to:~~

~~(i) non-controlling interests, and~~

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

~~(b) total comprehensive income for the period attributable to:~~

~~(i) non-controlling interests, and~~

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

84 [Deleted]~~An entity may present in a separate income statement (see paragraph 81) the line items in paragraph 82(a)–(f) and the disclosures in paragraph 83(a).~~

85 An entity shall present additional line items, headings and subtotals in the statement(s) presenting ~~of~~profit or loss and other comprehensive income ~~and the separate income statement (if presented),~~ when such presentation is relevant to an understanding of the entity's financial performance.

86 Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement(s) presenting ~~of~~ profit or loss and other comprehensive income ~~and in the separate income statement (if presented),~~ and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. For example, a financial institution may amend the descriptions to provide information that is relevant to the operations of a financial institution. An entity does not offset income and expense items unless the criteria in paragraph 32 are met.

87 An entity shall not present any items of income or expense as extraordinary items, in the statement(s) presenting ~~of~~ profit or loss and other comprehensive income ~~or the separate income statement (if presented),~~ or in the notes.

Profit or loss for the period

88 An entity shall recognise all items of income and expense in a period in profit or loss unless an HKFRS requires or permits otherwise.

89 Some HKFRSs specify circumstances when an entity recognises particular items outside profit or loss in the current period. HKAS 8 specifies two such circumstances: the correction of errors and the effect of changes in accounting policies. Other HKFRSs require or permit components of other comprehensive income that meet the *Framework*'s* definition of income or expense to be excluded from profit or loss (see paragraph 7).

Other comprehensive income for the period

90 An entity shall disclose the amount of income tax relating to each ~~component~~ item of other comprehensive income, including reclassification adjustments, either in the statement of profit or loss and other comprehensive income or in the notes.

91 An entity may present ~~components~~ items of other comprehensive income either:

(a) net of related tax effects, or

(b) before related tax effects with one amount shown for the aggregate amount of income tax relating to those ~~components~~ items.

If an entity elects alternative (b), it shall allocate the tax between the items that might be reclassified subsequently to the profit or loss section and those that will not be reclassified subsequently to the profit or loss section.

92 An entity shall disclose reclassification adjustments relating to components of other comprehensive income.

93 Other HKFRSs specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments. A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss. For example, gains realised on the disposal of available-for-sale financial assets are included in profit or loss of the current period. These amounts may have been recognised in other comprehensive income as unrealised gains in the current or previous periods. Those unrealised gains must be deducted from other comprehensive income in the period in which the realised gains are reclassified to profit or loss to avoid including them in total comprehensive income twice.

94 An entity may present reclassification adjustments in the statement(s) of profit or loss and other comprehensive income or in the notes. An entity presenting reclassification adjustments in the notes presents the items ~~components~~ of other comprehensive income after any related reclassification adjustments.

95 Reclassification adjustments arise, for example, on disposal of a foreign operation (see HKAS 21), on derecognition of available-for-sale financial assets (see HKAS 39) and when a hedged forecast transaction affects profit or loss (see paragraph 100 of HKAS 39 in relation to cash flow hedges).

96 Reclassification adjustments do not arise on changes in revaluation surplus recognised in accordance with HKAS 16 or HKAS 38 or on remeasurements of ~~actuarial gains and losses on~~ defined benefit plans recognised in accordance with ~~paragraph 93A of~~ HKAS 19. These components are recognised in other comprehensive income and are not reclassified to profit or loss in subsequent periods. Changes in revaluation surplus may be transferred to retained earnings in subsequent periods as the asset is used or when it is derecognised (see HKAS 16 and HKAS 38). ~~Actuarial gains and losses are reported in retained earnings in the period that they are recognised as other comprehensive income (see HKAS 19).~~

* In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

Information to be presented in the statement(s) of profit or loss and other comprehensive income or in the notes

97 **When items of income or expense are material, an entity shall disclose their nature and amount separately.**

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

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

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

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

(d) disposals of investments;

(e) discontinued operations;

(f) litigation settlements; and

(g) other reversals of provisions.

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

100 Entities are encouraged to present the analysis in paragraph 99 in the statement(s) presenting ~~of~~ profit or loss and other comprehensive income ~~or in the separate income statement (if presented)~~.

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

102 The first form of analysis is the 'nature of expense' method. An entity aggregates expenses within profit or loss according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and does not reallocate them among functions within the entity. This method may be simple to apply because no allocations of expenses to functional classifications are necessary. An example of a classification using the nature of expense method is as follows:

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

103 The second form of analysis is the 'function of expense' or 'cost of sales' method and classifies expenses according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses. This method can provide more relevant information to users than the classification of expenses by nature, but allocating costs to functions may require arbitrary allocations and involve considerable judgement. An example of a classification using the function of expense method is as follows:

Revenue	X
Cost of sales	(X)
Gross profit	X
Other income	X
Distribution costs	(X)
Administrative expenses	(X)
Other expenses	(X)
Profit before tax	X

104 An entity classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense.

105 The choice between the function of expense method and the nature of expense method depends on historical and industry factors and the nature of the entity. Both methods provide an indication of those costs that might vary, directly or indirectly, with the level of sales or production of the entity. Because each method of presentation has merit for different types of entities, this Standard requires management to select the presentation that is reliable and more relevant. However, because information on the nature of expenses is useful in predicting future cash flows, additional disclosure is required when the function of expense classification is used. In paragraph 104, 'employee benefits' has the same meaning as in HKAS 19.

Statement of changes in equity

Information to be presented in the statement of changes in equity

106 An entity shall present a statement of changes in equity as required by paragraph 10. The statement of changes in equity includes the following information:

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

(b) for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with HKAS 8; and

(c) [deleted]

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

(i) profit or loss;

(ii) other comprehensive income; and

(iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

Information to be presented in the statement of changes in equity or in the notes

106A For each component of equity an entity shall present, either in the statement of changes in equity or in the notes, an analysis of other comprehensive income by item (see paragraph 106(d)(ii)).

107 An entity shall present, either in the statement of changes in equity or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share.

108 In paragraph 106, the components of equity include, for example, each class of contributed equity, the accumulated balance of each class of other comprehensive income and retained earnings.

109 Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period.

110 HKAS 8 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transition provisions in another HKFRS require otherwise. HKAS 8 also requires restatements to correct errors to be made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance of retained earnings, except when an HKFRS requires retrospective adjustment of another component of equity. Paragraph 106(b) requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies and, separately, from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.

Statement of cash flows

111 Cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. HKAS 7 sets out requirements for the presentation and disclosure of cash flow information.

Notes

Structure

112 The notes shall:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with paragraphs 117–124;

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

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

113 An entity shall, as far as practicable, present notes in a systematic manner. An entity shall cross-reference each item in the statements of financial position and ~~of~~ <u>in the statement(s) of profit or loss and other </u>comprehensive income, ~~in the separate income statement (if presented),~~ and in the statements of changes in equity and of cash flows to any related information in the notes.

114 An entity normally presents notes in the following order, to assist users to understand the financial statements and to compare them with financial statements of other entities:

(a) statement of compliance with HKFRSs (see paragraph 16);

(b) summary of significant accounting policies applied (see paragraph 117);

(c) supporting information for items presented in the statements of financial position and ~~of~~ <u>in the statement(s) of profit or loss and other </u>comprehensive income, ~~in the separate income statement (if presented),~~ and in the statements of changes in equity and of cash flows, in the order in which each statement and each line item is presented; and

(d) other disclosures, including:

(i) contingent liabilities (see HKAS 37) and unrecognised contractual commitments, and

(ii) non-financial disclosures, eg the entity's financial risk management objectives and policies (see HKFRS 7).

115 In some circumstances, it may be necessary or desirable to vary the order of specific items within the notes. For example, an entity may combine information on changes in fair value recognised in profit or loss with information on maturities of financial instruments, although the former disclosures relate to the statement<u>(s) presenting</u> ~~of~~ <u>profit or loss and other</u> comprehensive income ~~or separate income statement (if presented)~~ and the latter relate to the statement of financial position. Nevertheless, an entity retains a systematic structure for the notes as far as practicable.

116 An entity may present notes providing information about the basis of preparation of the financial statements and specific accounting policies as a separate section of the financial statements.

Disclosure of accounting policies

117 An entity shall disclose in the summary of significant accounting policies:

(a) the measurement basis (or bases) used in preparing the financial statements, and

(b) the other accounting policies used that are relevant to an understanding of the financial statements.

118 It is important for an entity to inform users of the measurement basis or bases used in the financial statements (for example, historical cost, current cost, net realisable value, fair value or recoverable amount) because the basis on which an entity prepares the financial statements significantly affects users' analysis. When an entity uses more than one measurement basis in the financial statements, for example when particular classes of assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.

119 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in HKFRSs. An example is disclosure of whether ~~a venturer recognises its interest in a jointly controlled entity using proportionate consolidation or the equity method (see HKAS 31 *Interests in Joint Ventures*)~~ an entity applies the fair value or cost model to its investment property (see HKAS 40 *Investment Property*). Some HKFRSs specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, HKAS 16 requires disclosure of the measurement bases used for classes of property, plant and equipment.

120 Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. For example, users would expect an entity subject to income taxes to disclose its accounting policies for income taxes, including those applicable to deferred tax liabilities and assets. When an entity has significant foreign operations or transactions in foreign currencies, users would expect disclosure of accounting policies for the recognition of foreign exchange gains and losses.

121 An accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by HKFRSs but the entity selects and applies in accordance with HKAS 8.

122 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

123 In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:

(a) whether financial assets are held-to-maturity investments;

(b) when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities; and

(c) whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue~~; and~~.

~~(d) whether the substance of the relationship between the entity and a special purpose entity indicates that the entity controls the special purpose entity.~~

124 Some of the disclosures made in accordance with paragraph 122 are required by other HKFRSs. For example, ~~HKAS 27 requires an entity to disclose the reasons why the entity's ownership interest does not constitute control, in respect of an investee that is not a subsidiary even though more than half of its voting or potential voting power is owned directly or indirectly through subsidiaries~~ HKFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose the judgements it has made in determining whether it controls another entity. HKAS 40 ~~*Investment Property*~~ requires disclosure of the criteria developed by the entity to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business, when classification of the property is difficult.

Sources of estimation uncertainty

125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

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

126 Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence on inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates, future changes in salaries and future changes in prices affecting other costs.

127 The assumptions and other sources of estimation uncertainty disclosed in accordance with paragraph 125 relate to the estimates that require management's most difficult, subjective or complex judgements. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a consequential material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.

128 The disclosures in paragraph 125 are not required for assets and liabilities with a significant risk that their carrying amounts might change materially within the next financial year if, at the end of the reporting period, they are measured at fair value based on ~~recently observed market prices~~a quoted price in an active market for an identical asset or liability. Such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.

129 An entity presents the disclosures in paragraph 125 in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other sources of estimation uncertainty. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures an entity makes are:

(a) the nature of the assumption or other estimation uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and

(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

130 This Standard does not require an entity to disclose budget information or forecasts in making the disclosures in paragraph 125.

131 Sometimes it is impracticable to disclose the extent of the possible effects of an assumption or another source of estimation uncertainty at the end of the reporting period. In such cases, the entity discloses that it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from the assumption could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.

132 The disclosures in paragraph 122 of particular judgements that management made in the process of applying the entity's accounting policies do not relate to the disclosures of sources of estimation uncertainty in paragraph 125.

133 Other HKFRSs require the disclosure of some of the assumptions that would otherwise be required in accordance with paragraph 125. For example, HKAS 37 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. ~~HKFRS 7~~ HKFRS 13 *Fair Value Measurement* requires disclosure of significant assumptions (including the valuation technique(s) and inputs) the entity uses when measuring ~~in estimating~~ the fair values of ~~financial~~ assets and ~~financial~~ liabilities that are carried at fair value. ~~HKAS 16 requires disclosure of significant assumptions that the entity uses in estimating the fair values of revalued items of property, plant and equipment.~~

Capital

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

135 To comply with paragraph 134, the entity discloses the following:

(a) qualitative information about its objectives, policies and processes for managing capital, including:

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

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

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

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

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

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

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

The entity bases these disclosures on the information provided internally to key management personnel.

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

Puttable financial instruments classified as equity

136A For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

(a) summary quantitative data about the amount classified as equity;

(b) its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;

(c) the expected cash outflow on redemption or repurchase of that class of financial instruments; and

(d) information about how the expected cash outflow on redemption or repurchase was determined.

Other disclosures

137 An entity shall disclose in the notes:

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

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

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

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

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

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

(d) if it is a limited life entity, information regarding the length of its life.

Transition and effective date

139 An entity shall apply this Standard for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity adopts this Standard for an earlier period, it shall disclose that fact.

139A HKAS 27 (as amended in 2008) amended paragraph 106. An entity shall apply that amendment for annual periods beginning or or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendment shall be applied for that earlier period. The amendment shall be applied retrospectively.

139B *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to HKAS 32 and HKAS 1), issued in June 2008, amended paragraph 138 and inserted paragraphs 8A, 80A and 136A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 32, HKAS 39, HKFRS 7 and HK(IFRIC)-Int 2 *Members' Shares in Co-operative Entities and Similar Instruments* at the same time.

139C Paragraphs 68 and 71 were amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

139D Paragraph 69 was amended by *Improvements to HKFRSs* issued in May 2009. An entity shall apply that amendment for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

139E *[This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]*

139F Paragraphs 106 and 107 were amended and paragraph 106A was added by *Improvements to HKFRSs* issued in May 2010. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

139G *[This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]*

139H HKFRS 10 and HKFRS 12, issued in June 2011, amended paragraphs 4, 119, 123 and 124. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 12.

139I HKFRS 13, issued in June 2011, amended paragraphs 128 and 133. An entity shall apply those amendments when it applies HKFRS 13.

139J *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraphs 7, 10, 82, 85–87, 90, 91, 94, 100 and 115, added paragraphs 10A, 81A, 81B and 82A, and deleted paragraphs 12, 81, 83 and 84. An entity shall apply those amendments for annual periods beginning on or after 1 July 2012. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

139K HKAS 19 *Employee Benefits* (as amended in July 2011) amended the definition of 'other comprehensive income' in paragraph 7 and paragraph 96. An entity shall apply those amendments when it applies HKAS 19 (as amended in July 2011).

139L *Annual Improvements 2009–2011 Cycle*, issued in June 2012, amended paragraphs 10, 38 and 41, deleted paragraphs 39–40 and added paragraphs 38A–38D and 40A–40D. An entity shall apply that amendment retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Withdrawal of HKAS 1 (issued 2004)

140 This Standard supersedes HKAS 1 *Presentation of Financial Statements* issued in 2004, as amended in 2005.

Appendix A
Amendments to other pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2009. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

***

The amendments contained in this appendix when this Standard was revised in 2007 have been incorporated into the relevant pronouncements.

Appendix B
Comparison with International Accounting Standards

This comparison appendix, which was prepared as at December 2007 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 1.

The International Accounting Standard comparable with HKAS 1 is IAS 1 *Presentation of Financial Statements*.

The following sets out the major textual difference between HKAS 1 and IAS 1 and the reason for the difference.

Difference	Reason for the differences
(i) IAS 1 paras 15-24 vs HKAS 1 paras 15-24 The terms 'fair presentation' and 'present fairly' used in IAS 1 are replaced by the terms 'true and fair view' and 'achieve a true and fair view' in HKAS 1	To match with the terms used in the Hong Kong Companies Ordinance

Appendix C
Notes on Legal Requirements in Hong Kong

This appendix accompanies, but is not part of, HKAS 1.

The following sets out the legal requirements in Hong Kong that are pertinent to each Hong Kong Accounting Standards or Hong Kong Financial Reporting Standards. The references to "the Schedule" below are to the Tenth Schedule to the Companies Ordinance ("CO")(Cap. 32) which continues to be effective for financial statements covering a period beginning on or before 2 March 2014.

1.	**HKAS 1 *Presentation of Financial Statements***
	Sections 122 and 123 of the CO requires the directors of a company to prepare a profit and loss account for each financial year, and a balance sheet as at the last day of that year. The accounts must give a true and fair view of the profit or loss and of the state of affairs of the company, and comply with the requirements of the Schedule. Based on the communication with International Accounting Standards Board, the HKICPA believes that the term 'true and fair view' and the term 'fair presentation' used in IAS 1, *Presentation of Financial Statements* are equivalent terms. Please also refer to paragraph 46 of the Framework which contains certain references to the two terms. Sections 124 to 126 of the CO requires, where a company has a subsidiary at the end of its financial year, the directors of a company to prepare group accounts unless the company is, at the end of its financial year, a wholly owned subsidiary of another body corporate. Group accounts, which normally comprise a consolidated balance sheet and a consolidated profit and loss account, must give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries. Section 129D of the CO requires a directors' report to be attached to every balance sheet laid before a company in general meeting. The legal requirements with regard to the content of a directors' report are dealt with in Sections 129D, 129E and 141C of the CO. Section 122 of the CO requires a company's accounts, together with the directors' report and auditors' reports to be laid before the company at its annual general meeting and the accounts of private companies (other than a private company which is a member of a group of companies which includes a non-private company) and companies limited by guarantee, and all other companies to be made up to not more than 9 and 6 months, respectively, prior to the meeting. Section 111 of the CO requires that, unless approved by the Registrar of Companies, no more than 15 months should elapse between the date of one annual general meeting and the next, and that the first annual general meeting of the company must be held within 18 months of its incorporation. In general terms the legal requirements with regard to the form and content of the accounts are dealt with, inter alia, in Section 122 to 129A and Sections 161 to 161C of the CO and the Schedule.
2	**HKAS 2 *Inventories***
	Paragraph 12(13) of the Schedule requires the disclosure of the manner in which the carrying amount of stock in trade or work in progress has been calculated.

3	**HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors***
	Paragraph 17(6)* of the Schedule requires disclosure of the following: "Any material respects in which any items shown in the profit and loss account are affected – ***a. by transactions of a sort not usually undertaken by the company or otherwise by circumstances of an exceptional or non-recurrent nature; or*** b. by any change in the basis of accounting."
4	**HKAS 10 *Events After the Reporting Period***
	Paragraph 9(1)(e) of the Schedule requires the disclosure of the aggregate amount which is recommended for distribution by way of dividend under a separate heading(s) in the balance sheet. Paragraph 13(1)(j) of the Schedule requires the disclosure of the aggregate amount of the dividend paid and proposed in the profit and loss account.
5	**HKAS 11 *Construction Contracts***
	Paragraph 12(13) of the Schedule requires the disclosure of the manner in which the carrying amount of stock in trade or work in progress has been calculated.
6	***HKAS 12* Incomes Taxes**
	Paragraph 8* of the Schedule requires that if an amount is set aside for the purpose of its being used to prevent undue fluctuations in charges for taxation, it shall be stated. Paragraph 12(12)* the Schedule requires that, if such amount has been used during the financial year for another purpose, the amount thereof and the fact that it has been so used shall be stated. Paragraph 12(15) of the Schedule requires disclosure of the basis on which the amount, if any, set aside for Hong Kong profits tax is computed. Paragraph 13(1)(c)* of the Schedule requires disclosure of the amount of the charge to revenue for taxes imposed by the Inland Revenue Ordinance and, if that amount would have been greater but for relief from double taxation, the amount which it would have been but for such relief, and the amount of the charge for taxation imposed outside Hong Kong of profits, income and (so far as charged to revenue) capital gains. Paragraph 17(3)* of the Schedule requires that the basis on which the charge for Hong Kong profit tax is computed shall be stated. Particulars are required of any special circumstances affecting the tax liability for the financial year or succeeding financial years (paragraph 17(4) of the Schedule).

7	**HKAS 16 *Property, Plant and Equipment***
	Paragraph 4† of the Schedule requires that fixed assets, current assets and assets that are neither fixed nor current shall be separately identified, and that the method used to arrive at the amount of fixed assets under each heading should be stated. Paragraph 5*† of the Schedule requires disclosure of the aggregate amount of the cost or valuation of fixed assets under appropriate headings and of the aggregate amount provided or written off since the date of acquisition or valuation for depreciation or diminution in value. Paragraph 10 of the Schedule requires that where any liability of the company is secured otherwise than by operation of law on any assets of the company, the fact that that liability is so secured shall be stated, but it shall not be necessary to specify the assets on which the liability is secured. Paragraph 12(4)† of the Schedule requires disclosure of particulars of any charge on the assets of the company to secure the liabilities of any other person, including, where practicable, the amount secured. Paragraph 12(6) of the Schedule requires disclosure of, where practicable, the aggregate amount or estimated amount, if it is material, of contracts for capital expenditure, so far as not provided for and the aggregate amount or estimated amount, if it is material, of capital expenditure authorised by the directors which has not been contracted for. Paragraph 12(7)*† of the Schedule requires disclosure of the years in which fixed assets were severally valued and their respective values, and in the case of assets valued during the financial period: a. the names of the persons who valued them or particulars of their qualifications for doing so; and b. the bases of valuation used by such persons. Paragraph 12(8)* of the Schedule requires disclosure of the amounts of fixed assets acquired or disposed of during the year under each heading. Where fixed assets include land, paragraph 12(9)* requires separate disclosure of the amounts ascribable to: a. land in Hong Kong held on long lease (not less than 50 years), medium-term lease (10 to 50 years) and short lease (under 10 years) respectively; and b. land outside Hong Kong held freehold, on long lease, medium-term lease and short lease respectively. Under paragraph 13(1)(a)*† of the Schedule disclosure must be made of the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets.

8	**HKAS 17 *Leases***
	Paragraph 13(1)(i)*† of the Schedule requires disclosure of the amount, if material, charged to revenue in respect of sums payable in respect of the hire of plant and machinery.
9	**HKAS 18 *Revenue***
	Paragraph 13(1)(g)*† of the Schedule requires disclosure of the amounts respectively of income from listed investments and income from unlisted investments. Paragraph 13(1)(h)† requires disclosure of rents from land and buildings (after deduction of ground rents, rates and other out-going) if a substantive part of the company's revenue for the financial year consists of such rents. Paragraph 16 of the Schedule requires disclosure of turnover and the method by which it is arrived at. Turnover should consist of revenue arising from the principal activities of the entity and therefore should not usually include those items of revenue and gains that arise incidentally.
10	**HKAS 19 *Employee Benefits***
	The legal requirements as regards the disclosure of directors' emoluments, rights to acquire shares or debentures and other benefits are dealt with in the section below concerning HKAS 24 *Related Party Disclosures*. Under the Employment Ordinance, an enterprise 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. Based on the enterprise's past experience and the directors' knowledge of the business and work force, it is probable that the enterprise will have to make long service payments to some employees on termination of their employment or retirement. Such long service payments are accounted for as "post-employment benefits: defined benefit plans". Paragraph 30(1) of the Schedule defines "provision" as any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or any amount retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. The amount provided for certain employee benefits (e.g. pensions) falls within this definition. Paragraph 4(1)† of the Schedule requires the classification of provisions under headings appropriate to the company's business. Paragraph 6*† of the Schedule requires the disclosure of the aggregate amount of provisions (other than provisions for depreciation, renewals and diminution in value of assets) under separate headings. Paragraph 7*† of the Schedule requires the disclosure of the source of any increase and the application of any decrease in each sub-heading of provisions.

	Paragraph 13(1)(f)*† of the Schedule requires the disclosure of the amount set aside to provisions (other than provisions for depreciation, renewals and diminution in value of assets) or the amount withdrawn from such provisions and not applied for the purposes of the provisions, if its is material. Paragraph 12(5)*† of the Schedule requires the disclosure of the general nature of any other contingent liabilities not provided for, and, when practicable, the aggregate amount or estimated amount of those liabilities, if it is material.
11	**HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance***
	Paragraph 4† of the Schedule requires that the method used to arrive at the amount of fixed assets under each heading should be stated. Paragraph 5*† of the Schedule requires disclosure of the aggregate amount of the cost or valuation of fixed assets under appropriate headings and of the aggregate amount provided or written off since the date of acquisition or valuation for depreciation or diminution in value. Paragraph 12(5)*† of the Schedule requires disclosure of the general nature of any other contingent liabilities not provided for, and, when practicable, the aggregate amount or estimated amount of those liabilities, if it is material.
12	**HKAS 21 *The Effects of Changes in Foreign Exchange Rates***
	Paragraph 12(14)* of the schedule requires disclosure of the basis on which other currencies have been converted into currency in which the balance sheet is expressed, where the amount of the assets or liabilities affected is material.
13	**HKAS 22 *Business Combinations***
	The legal requirements in Hong Kong with regard to the form and content of group accounts and other matters relating to subsidiaries of a company are dealt with in the section below concerning HKAS 27 *Consolidated and Separate Financial Statements*. The Schedule contains the following disclosure requirements for goodwill: a. Balance sheet Paragraph 9(1)(b) of the Schedule requires the disclosure of the unamortised balance of goodwill either as a separate item or aggregated with any unamortised balances on patents and trademarks. This requirement applies whether the goodwill is carried as a separate balance in the books or can only be ascertained from contracts or documents. b. Profit and loss account The amortisation treatment involves the allocation of cost of purchased goodwill over its useful life and can be regarded as depreciation within the meaning of the Schedule. Therefore the disclosure requirements of paragraph 13(1)(a)*† of that Schedule apply and the amount charged to revenue for amortisation of goodwill should be disclosed.

14	HKAS 23 ***Borrowing Costs***
	Paragraph 13(1)(b)* of the Schedule requires disclosure of the following: "the amount of the interest on loans of the following kinds made to the company (whether on the security of debentures or not), namely, bank loans, overdrafts and loans which, not being bank loans or overdrafts, i. are repayable otherwise than by instalments and fall due for repayment before the expiration of the period of 5 years beginning with the day next following the expiration of the financial year; or ii. are repayable by instalments the last of which falls due for payment before the expiration of that period; and the amount of the interest on loans of other kinds so made (whether on the security of debentures or not)".
15	**HKAS 24 *Related Party Disclosures***
	Section 128 of the CO requires that if at the end of its financial year, a company has subsidiaries, the following should be disclosed in the accounts: a. the subsidiary's name; b. its country of incorporation; and c. in relation to shares of each class of the subsidiary held by the company, the identity of the class and the proportion of the nominal value of the issued shares of that class represented by the shares held. Section 129 of the CO requires, subject to certain exemption set out in sections 129(3) to 129(5) that if at the end of its financial year, a company holds more than 20% of any class of issued shares of another body corporate (not being a subsidiary), or the shareholding in another body corporate (not being a subsidiary) exceeds 10% of the total assets of the company, the following should be disclosed: a. the name of that other body corporate; b. its country of incorporation; and c. the identity of the class and the proportion of the nominal value of the issued shares of that class represented by the shares held. Section 129A of the CO requires disclosure of the name and country of incorporation of the body corporate regarded by the directors as being the company's ultimate holding company. Section 129D(3)(i) of the CO requires disclosure in the directors' report of the names of the persons who, at any time during the financial year, were directors of the company. Section 129D(3)(ia) of the CO requires disclosure in the directors' report of a statement of the existence and duration of any contract in force during the year for the management and administration of the whole or any substantial part of the company's business, together with the name of any director interested therein. Section 129D(3)(j) of the CO requires disclosure in the directors' report of any interest of a director in a contract with the company or its subsidiary, holding company or fellow subsidiary, if, in the opinion of the directors, the contract is significant in relation to the company's business and the director's interest is material, whether directly or indirectly, at any time in the year, stating:

	a. the fact that the contract subsists or subsisted; b. the names of the parties involved (other than the company); c. the name of the director (if not a party); d. the nature of the contract; and e. the nature of the director's interest. This does not apply to directors' service contracts nor to contracts between the company and another body corporate where a director's only interest is by virtue of his being a director of that other body. Section 129D(3)(k) of the CO requires disclosure in the directors' report of any directors' rights to acquire shares or debentures, in the company or any other body corporate, under any arrangement to which the company or its subsidiary, holding company or fellow subsidiary is a party, explaining the effects of the arrangement and giving the names of all directors during the year who held shares or debentures acquired pursuant to the arrangement. Section 161 of the CO requires disclosure of the following, distinguishing between emoluments in respect of services as director (of the company or its subsidiary) and other emoluments: a. the aggregate amount of directors' emoluments; b. the aggregate amount of directors' or past directors' pensions; and c. the aggregate amount of any compensation to directors or past directors in respect of loss of office, distinguishing between sums paid by or receivable from the company, its subsidiaries and any other persons. Section 161B [Φ] of the CO requires the accounts to contain certain particulars of every relevant transaction, being a loan, quasi-loan or credit transaction, entered into by the company during that financial year or, if made or entered into before it, is outstanding at any time during that financial year to the following parties: a. a director or an officer of the company; b. a director of its holding company; c. a body corporate controlled by a director of the company; or d. persons etc. connected with a director of the company or of its holding company; Paragraph 9(1)(c) of the Schedule requires disclosure of loans to employees, or to trustees for employees (including salaried directors), to purchase fully paid shares in the company or in its holding company. Paragraph 18(2)* of the CO of the Schedule requires the aggregate amounts of shares in, and the amounts owing from (and indebtedness to) the company's subsidiaries to be set out separately from all other assets (and liabilities) of the company.

	Paragraph 18(3)* of the CO requires disclosure of the number, description and amount of the shares in and debentures of the company held by its subsidiaries or their nominees except where the subsidiaries or their nominees hold the shares as trustees and neither the company nor the subsidiaries have any beneficial interest in those shares. Paragraph 19(1)* of the CO of the Schedule requires disclosure of the aggregate amounts owing from and indebtedness to the company's holding companies and fellow subsidiaries, and the aggregate amount of assets consisting of shares in fellow subsidiaries.
16	**HKAS 27 *Consolidated and Separate Financial Statements***
	Under section 2(4) of the CO, a company shall be deemed to be a subsidiary of another company, if: a. that other company: i. controls the composition of the board of directors of the first mentioned company; or ii. controls more than half of the voting power of the first mentioned company; or iii. holds more than half of the issued share capital of the first mentioned company (excluding any part of it which carries no right to participate beyond a specified amount in a distribution of either profits or capital); or b. the first mentioned company is a subsidiary of any company which is that other company's subsidiary. For the purposes of defining a subsidiary under section 2(4) of the CO, section 2(5) of the CO states that the composition of a company's board of directors shall be deemed to be controlled by another company if that other company by the exercise of some power exercisable by it, without the consent of any other person, can appoint or remove all or a majority of the directors, and, for the purposes of this provision, that other company shall be deemed to have power to make such an appointment if: a. a person cannot be appointed as a director without the exercise in his favour by that other company of such a power; or b. a person's appointment as a director follows necessarily from his being a director or other officer of that other company.

The Companies (Amendment) Ordinance 2005 introduced a definition of "parent undertaking" and "subsidiary undertaking". A provision to deem a holding company to include a parent company and a subsidiary to include a subsidiary undertaking was added in Section 2B. In essence, this enable Hong Kong incorporated companies to use the definition of subsidiary in HKAS 27 for the purpose of preparing group accounts. Parent undertaking and subsidiary undertaking are defined in Schedule 23 as follows:

(1) An undertaking is a parent undertaking ("parent undertaking") in relation to another undertaking ("subsidiary undertaking") if—

(a) (i) in the case where both the parent undertaking and the subsidiary undertaking are bodies corporate, the subsidiary undertaking is a subsidiary of the parent undertaking by virtue of section 2(4), (5), (6) and (7) of the CO; or

(ii) in any other case, the parent undertaking—
(A) holds a majority of the voting rights in the subsidiary undertaking;
(B) is a member of the subsidiary undertaking and has the right to appoint or remove a majority of its board of directors; or
(C) is a member of the subsidiary undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the subsidiary undertaking; or

(b) the parent undertaking has the right to exercise a dominant influence over the subsidiary undertaking by virtue of—
(i) the provisions contained in the subsidiary undertaking's memorandum or articles or equivalent constitutional documents; or
(ii) a control contract.

(2) For the purposes of subsection (1)(a)(ii), an undertaking shall be treated as a member of another undertaking ("the relevant undertaking"), if—

(a) any of its subsidiary undertakings is a member of the relevant undertaking; or

(b) any shares in the relevant undertaking are held by a person acting on behalf of the first-mentioned undertaking or any of its subsidiary undertakings.

(3) An undertaking shall be treated as the parent undertaking of another undertaking if a subsidiary undertaking of the first-mentioned undertaking is, or is to be treated as, the parent undertaking of that other undertaking; and references to a subsidiary undertaking of the first-mentioned undertaking shall be construed accordingly.

The obligation to lay group accounts before the members of a holding company in general meeting is set out in section 124(1) of the CO. In general terms the form and content of group accounts are dealt with inter alia in sections 125 and 126 of the CO and in the Schedule.

Under section 124(2)(a) of the CO group accounts shall not be required where the holding company is at the end of its financial year the wholly-owned subsidiary of another body corporate.

Section 124(2)(b) of the Companies Ordinance also allows group accounts (subject to approval of the Financial Secretary in certain instances) not to deal with a subsidiary if the company's directors are of the opinion that:

a. it is impracticable, or would be of no real value to members of the company, in view of the insignificant amount involved, or would involve expense or delay out of proportion to the value to members of the company; or

b. the result would be misleading, or harmful to the business of the company or any of its subsidiaries; or

c. the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

It should be noted that HKAS 27 takes the view that all subsidiaries should be included in the consolidated financial statements.

In general, section 125 of the CO requires group accounts to be presented in the form of consolidated accounts and should comprise a consolidated balance sheet and a consolidated profit and loss account dealing with the state of affairs and profit or loss of the company and its subsidiaries. However, section 125 of the CO also accepts that group accounts may be presented in a form other than a single set of consolidated accounts under certain conditions. It is generally accepted that consolidated financial statements are usually the best means of achieving the objective of giving a true and fair view of the profit or loss and of the state of affairs of the group. It should be noted that, where subsidiaries are not dealt with in group accounts or are being dealt with in a form of group accounts other than consolidated financial statements, information may still be required by law about the results of these subsidiaries and the extent to which they have been dealt with in the accounts of the holding company (paragraphs 18(4) and 24 of the Schedule).

Section 127(1) of the of the CO states that a holding company's directors shall secure that, except where in their opinion there are good reasons against it, the financial year of each of its subsidiaries shall coincide with the company's own financial year.

Section 126(2) of the CO requires that, if the financial year of a subsidiary is not co-terminous with that of the holding company, the group accounts shall deal with the subsidiary's results and state of affairs as of the last financial year ending on or before the date of the holding company's balance sheet. It also requires the disclosure of the reasons why the financial year of a subsidiary does not coincide with that of the holding company.

Paragraph 18(2) and 19(1) of the Schedule require disclosure of the aggregate amounts of shares in, and the amounts owing from and indebtedness to, the subsidiaries and fellow subsidiaries.

	Paragraphs 18(4), 18(5) and 24(b) of the Schedule require disclosure of the following information where group accounts are not submitted: a. the reasons why subsidiaries are not dealt with in group accounts; b. the net aggregate amount attributable to the holding company of the profits less losses of such subsidiaries, dealt with this year and not dealt with, in the company's accounts, both for: – the financial years of subsidiaries ending with or during the financial year of the company; and – their previous financial years since acquisition; and c. any material qualifications in the auditors' report and any note to the accounts disclosing a matter which, in the absence of such disclosure, would have been referred to in an audit report qualification, to the extent that the matter is not referred to in the holding company's audit report and is material from the point of view of its members. Paragraphs 18(6) and 25 of the Schedule requires disclosure of the following information where group accounts are not submitted and the subsidiaries' financial year did not end with that of the company: a. the reasons why the company's directors consider that the subsidiaries' financial years should not end with that of the company; and b. the dates on which the subsidiaries' financial years ending last before that of the company respectively ended or the earliest and latest of those dates. The Companies (Amendment) Ordinance 2005, in general, redefines the definition of "subsidiary" for the purpose of preparing group accounts to include a subsidiary undertaking as defined in the new Schedule 23 and includes a true and fair overriding provision. In essence, this would enable Hong Kong incorporated companies to use the definition of subsidiary in HKAS 27 for the purpose of preparing group accounts.
17	**HKAS 28 *Investment in Associates***
	Section 129 of the Companies Ordinance requires that if at the balance sheet date, a company holds more than 20% of any class of issued shares of another company, or the shareholding in another company exceeds 10% of the total assets of the investing company, the following should be disclosed subject to sections 129(3) to 129(5) of the CO: a. the name of that other company; b. its country of incorporation; and c. the identity of the class and the proportion of the nominal value of the issued share of that class represented by the shares held. In the case of an investee company which is either incorporated outside Hong Kong or carries on business outside Hong Kong, section 129(3) of the Companies Ordinance provides that disclosure of the company's name and other particulars need not be made if in the opinion of the directors and with the concurrence of the Financial Secretary such disclosure would be harmful.

	Paragraph 9(1)(a)† of the Schedule requires separate disclosure of the aggregate amounts respectively of listed investments and unlisted investments. Paragraph 9(3)† of the Schedule requires that the amount of listed investments in the balance sheet should be analysed into those listed in Hong Kong and those listed outside Hong Kong. Paragraph 12(5)† of the Schedule requires disclosure of the general nature of any other contingent liabilities not provided for and, where practicable, the aggregate amount or estimated amount of those liabilities, if it is material. Paragraph 12(6) of the Schedule requires disclosure of, where practicable, the aggregate amount or estimated amount, if it is material, of contracts for capital expenditure, so far as not provided for and the aggregate amount or estimated amount, if it is material, of capital expenditure authorised by the directors which has not been contracted for. Paragraph 13(1)(g)*† of the Schedule requires disclosure of the amounts respectively of income from listed investments and income from unlisted investments.
18	**HKAS 31 *Interests in Joint Ventures***
	Section 129 of the Companies Ordinance requires that if at the balance sheet date, a company holds more than 20% of any class of issued shares of another company, or the shareholding in another company exceeds 10% of the total assets of the investing company, the following should be disclosed: a. the name of that other company; b. its country of incorporation; and c. the identity of the class and the proportion of the nominal value of the issued shares of that class represented by the shares held. In the case of an investee company which is either incorporated outside Hong Kong or carries on business outside Hong Kong, section 129(3) of the Companies Ordinance provides that disclosure of a company's name and other particulars need not be made if in the opinion of the directors and with the concurrence of the Financial Secretary such disclosure would be harmful. Paragraph 9(1)(a)† of the Schedule requires separate disclosure of the aggregate amounts respectively of listed investments and unlisted investments. Paragraph 9(3)† of the Schedule requires that the amount of listed investments in the balance sheet should be analysed into those listed in Hong Kong and those listed outside Hong Kong. Paragraph 12(5)† of the Schedule requires disclosure of the general nature of any other contingent liabilities not provided for and, where practicable, the aggregate amount or estimated amount of those liabilities, if it is material. Paragraph 12(6) of the Schedule requires disclosure of, where practicable, the aggregate amount or estimated amount, if it is material, of contracts for capital expenditure, so far as not provided for and the aggregate amount or estimated amount, if it is material, of capital expenditure authorised by the directors which has not been contracted for. Paragraph 13(1)(g)*† of the Schedule requires disclosure of the amounts respectively of income from listed investments and income from unlisted investments.

19	**HKAS 36 *Impairment of Assets***
	Paragraph 30(1) of the Schedule defines "provision" as any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. This covers the definition of "impairment loss" in paragraph 5 of HKAS 36. Paragraph 4(1)† of the Schedule requires the classification of provisions under headings appropriate to the company's business. Paragraph 7*† of the Schedule requires the disclosure of the source of any increase and the application of any decrease in each sub-heading of provisions.
20	**HKAS 37 *Provisions, Contingent Liabilities And Contingent Assets***
	Paragraph 30(1) of the Schedule defines "provision" as any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or any amount retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. This definition is wider in scope than the definition in HKAS 37. Paragraph 4(1)† of the Schedule requires the classification of provisions under headings appropriate to the company's business. Paragraph 6*† of the Schedule requires the disclosure of the aggregate amount of provisions (other than provisions for depreciation, renewals and diminution in value of assets) under separate headings. Paragraph 7*† of the Schedule requires the disclosure of the source of any increase and the application of any decrease in each sub-heading of provisions. Paragraph 13(1)(f)*† of the Schedule requires the disclosure of the amount set aside to provisions (other than provisions for depreciation, renewals and diminution in value of assets) or the amount withdrawn from such provisions and not applied for the purposes of the provisions, if it is material. Paragraph 12(4)† of the Schedule requires the disclosure of particulars of any charge on the assets of the company to secure the liabilities of any other person, including, where practicable, the amount secured. Paragraph 12(5)† of the Schedule requires the disclosure of the general nature of any other contingent liabilities not provided for, and, when practicable, the aggregate amount or estimated amount of those liabilities, if it is material.

21	**HKAS 38 *Intangible Assets***
	Paragraph 9(1)(b) of the Schedule requires the disclosure of the unamortised balances on patents and trademarks either as separate items or aggregated with any unamortised balance of goodwill. This requirement applies whether the patents and trademarks are carried as balances in the books or can only be ascertained from contracts or documents. The amortisation treatment involves the allocation of the depreciable amount of an intangible asset over the best estimate of its useful life and can be regarded as depreciation within the meaning of the Schedule. Therefore, the disclosure requirements of paragraph 13(1)(a)*† of the Schedule apply and the amount charged to revenue for amortisation of an intangible asset should be disclosed.
22	**HKAS 40 *Investment Property***
	Paragraph 5*† of the Schedule requires disclosure of the aggregate amount of the cost or valuation of fixed assets under appropriate headings and of the aggregate amount provided or written off since the date of acquisition or valuation for depreciation or diminution in value. Paragraph 10 of the Schedule requires that where any liability of the company is secured otherwise than by operation of law on any assets of the company, the fact that that liability is so secured shall be stated, but it shall not be necessary to specify the assets on which the liability is secured. Paragraph 12(4)† of the Schedule requires disclosure of particulars of any charge on the assets of the company to secure the liabilities of any other person, including, where practicable, the amount secured. Paragraph 12(7)*† of the Schedule requires disclosure of the years in which fixed assets were severally valued and their respective values, and in the case of assets valued during the financial period: a. the name of the persons who valued them or particulars of their qualifications for doing so; and b. the bases of valuation used by such persons. Paragraph 12(8)*† of the Schedule requires disclosure of the aggregate amounts of fixed assets acquired or disposed of during the year under each heading. Where fixed assets include land, paragraph 12(9)* requires separate disclosure of the amounts ascribable to: a. land in Hong Kong held on long lease, medium-term lease and short lease respectively; and b. land outside Hong Kong held freehold, on long lease, medium-term lease and short lease respectively. Under paragraph 13(1)(a)*† of the Schedule disclosure must be made of the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets. Paragraph 13(1)(h)† of the Schedule requires disclosure of rental income from land and buildings (after deduction of ground rents, rates and other out-goings) if a substantive part of the company's revenue for the financial year consists of such rents.

23	**HKAS 41 *Agriculture***
	Paragraph 12(5)† of the Schedule requires disclosure of the general nature of any other contingent liabilities not provided for, and, when practicable, the aggregate amount or estimated amount of those liabilities, if it is material. Paragraph 12(7)*† of the Schedule requires disclosure of the years in which fixed assets were severally valued and their respective values, and in the case of assets valued during the financial period: a. the names of the persons who valued them or particulars of their qualifications for doing so; and b. the bases of valuation used by such persons. Under paragraph 13(1)(a)*† of the Schedule disclosure must be made of the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets.
24	**HKFRS 7 *Financial Instruments: Disclosures***
	Section 129 of the Companies Ordinance requires that if at the balance sheet date, a company holds more than 20% of any class of issued shares of another company, or the shareholding in another company exceeds 10% of the total assets of the investing company, the following should be disclosed: a. the name of that other company; b. its country of incorporation; and c. the identity of the class and the proportion of the nominal value of the issued shares of that class represented by the shares held. Paragraph 4(2)† of the Schedule requires fixed assets, current assets and assets that are neither fixed nor current to be separately identified. Paragraph 5*† of the Schedule requires that where the directors' valuation of unlisted investments is not given and such investments are classified as fixed assets, the following should be stated: a. cost or valuation as shown in the company's books; and b. any amount provided or written off for diminution in value. Paragraph 9(1)(a) of the Schedule requires separate disclosure of the aggregate amounts respectively of listed investments and unlisted investments. Paragraph 9(1)(d) requires disclosure of the aggregate amount of banks loans and overdrafts and the aggregate amount of loans (other than bank loans and overdrafts) repayable wholly in part more than five years from the balance sheet date. Paragraph 9(3)† of the Schedule requires that the carrying amounts of listed investments in the balance sheet should be analysed into those listed in Hong Kong and those listed outside Hong Kong. Paragraph 9(4) of the Schedule requires disclosure of the terms of repayments and the rate of interests for each loan, other than a bank loan or an overdraft, specified in paragraph 9(1)(d) of the Schedule

	Paragraph 12(10) of the Schedule requires that, if in the opinion of the directors, the realisable value of any current assets is less than the balance sheet value, a statement of that fact should be included in the accounts. Paragraph 12(11)*† of the Schedule requires disclosure of the aggregate market value of listed investments where it differs from the carrying amounts in the balance sheet. If the aggregate market value is higher than the Stock Exchange value, the Stock Exchange value should also be disclosed. Paragraph 13(1)(a)*† of the Schedule requires disclosure of the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets. Paragraph 13(1)(g)*† of the Schedule requires disclosure of the amounts respectively of income from listed investments and income from unlisted investments.

Notes:

* These requirements do not apply to banking companies that are entitled to certain disclosure exemptions under Part III of the Schedule.

† These requirements do not apply to insurance companies that are entitled to certain disclosure exemptions under Part III of the Schedule.

Φ This revised S161B of the CO came into operation for relevant transactions entered into by the company after 13 February 2004.

BASIS FOR CONCLUSIONS ON IAS 1 *PRESENTATION OF FINANCIAL STATEMENTS*

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

HKAS 1 is based on IAS 1 *Presentation of Financial statements*. In approving HKAS 1, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 1. Accordingly, there are no significant differences between HKAS 1 and IAS 1. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 1 referred to below generally correspond with those in HKAS 1.

CONTENTS

Basis for Conclusions on IAS 1 *Presentation of Financial Statements*

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

The International Accounting Standards Board revised IAS 1 Presentation of Financial Statements *in 2007 as part of its project on financial statement presentation. It was not the Board's intention to reconsider as part of that project all the requirements in IAS 1.*

For convenience, the Board has incorporated into this Basis for Conclusions relevant material from the Basis for Conclusions on the revision of IAS 1 in 2003 and its amendment in 2005. Paragraphs have been renumbered and reorganised as necessary to reflect the new structure of the Standard.

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

Introduction

BC1 The International Accounting Standards Committee (IASC) issued the first version of IAS 1 *Disclosure of Accounting Policies* in 1975. It was reformatted in 1994 and superseded in 1997 by IAS 1 *Presentation of Financial Statements*.* In 2003 the International Accounting Standards Board revised IAS 1 as part of the Improvements project and in 2005 the Board amended it as a consequence of issuing IFRS 7 *Financial Instruments: Disclosures*. In 2007 the Board revised IAS 1 again as part of its project on financial statement presentation. This Basis for Conclusions summarises the Board's considerations in reaching its conclusions on revising IAS 1 in 2003, on amending it in 2005 and revising it in 2007. It includes reasons for accepting some approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

The Improvements project—revision of IAS 1 (2003)

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of standards, including IAS 1. The project was undertaken in the light of queries and criticisms raised in relation to the standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within standards, to deal with some convergence issues and to make other improvements. The Board's intention was not to reconsider the fundamental approach to the presentation of financial statements established by IAS 1 in 1997.

BC3 In May 2002 the Board published an exposure draft of proposed *Improvements to International Accounting Standards*, which contained proposals to revise IAS 1. The Board received more than 160 comment letters. After considering the responses the Board issued in 2003 a revised version of IAS 1. In its revision the Board's main objectives were:

(a) to provide a framework within which an entity assesses how to present fairly the effects of transactions and other events, and assesses whether the result of complying with a requirement in an IFRS would be so misleading that it would not give a fair presentation;

(b) to base the criteria for classifying liabilities as current or non-current solely on the conditions existing at the balance sheet date;

(c) to prohibit the presentation of items of income and expense as 'extraordinary items';

* IASC did not publish a Basis for Conclusions.

(d) to specify disclosures about the judgements that management has made in the process of applying the entity's accounting policies, apart from those involving estimations, and that have the most significant effect on the amounts recognised in the financial statements; and

(e) to specify disclosures about sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

BC4 The following sections summarise the Board's considerations in reaching its conclusions as part of its Improvements project in 2003:

(a) departures from IFRSs (paragraphs BC23–BC30)

(b) criterion for exemption from requirements (paragraphs BC34–BC36)

(c) effect of events after the reporting period on the classification of liabilities (paragraphs BC39–BC48)

(d) results of operating activities (paragraphs BC55 and BC56)

(e) minority interest (paragraph BC59)*

(f) extraordinary items (paragraphs BC60–BC64)

(g) disclosure of the judgements management has made in the process of applying the entity's accounting policies (paragraphs BC77 and BC78)

(h) disclosure of major sources of estimation uncertainty (paragraphs BC79–BC84).

Amendment to IAS 1—*Capital Disclosures* (2005)

BC5 In August 2005 the Board issued an Amendment to IAS 1—*Capital Disclosures*. The amendment added to IAS 1 requirements for disclosure of:

(a) the entity's objectives, policies and processes for managing capital.

(b) quantitative data about what the entity regards as capital.

(c) whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

BC6 The following sections summarise the Board's considerations in reaching its conclusions as part of its amendment to IAS 1 in 2005:

(a) disclosures about capital (paragraphs BC85–BC89)

(b) objectives, policies and processes for managing capital (paragraphs BC90 and BC91)

(c) externally imposed capital requirements (paragraphs BC92–BC97)

(d) internal capital targets (paragraphs BC98–BC100).

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* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

Amendments to IAS 32 and IAS 1—*Puttable Financial Instruments and Obligations Arising on Liquidation* (2008)

BC6A In July 2006 the Board published an exposure draft of proposed amendments to IAS 32 and IAS 1 relating to the classification of puttable instruments and instruments with obligations arising only on liquidation. The Board subsequently confirmed the proposals and in February 2008 issued an amendment that now forms part of IAS 1.

Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)

BC6B In May 2010 the Board published an exposure draft of proposed amendments to IAS 1 relating to the presentation of items of other comprehensive income (OCI). The Board subsequently modified and confirmed the proposals and in June 2011 issued *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1). The amendments were developed in a joint project with the US national standard-setter, the Financial Accounting Standards Board (FASB), with the aim of aligning the presentation of OCI so that information in financial statements prepared by entities using IFRSs and entities using US generally accepted accounting principles (GAAP) can be more easily compared.

Financial statement presentation—Joint project

BC7 In September 2001 the Board added to its agenda the performance reporting project (in March 2006 renamed the 'financial statement presentation project'). The objective of the project was to enhance the usefulness of information presented in the income statement. The Board developed a possible new model for reporting income and expenses and conducted preliminary testing. Similarly, in the United States, the Financial Accounting Standards Board (FASB) added a project on performance reporting to its agenda in October 2001, developed its model and conducted preliminary testing. Constituents raised concerns about both models and about the fact that they were different.

BC8 In April 2004 the Board and the FASB decided to work on financial statement presentation as a joint project. They agreed that the project should address presentation and display not only in the income statement, but also in the other statements that, together with the income statement, would constitute a complete set of financial statements—the balance sheet, the statement of changes in equity, and the cash flow statement. The Board decided to approach the project in two phases. Phase A would address the statements that constitute a complete set of financial statements and the periods for which they are required to be presented. Phase B would be undertaken jointly with the FASB and would address more fundamental issues relating to presentation and display of information in the financial statements, including:

(a) consistent principles for aggregating information in each financial statement.

(b) the totals and subtotals that should be reported in each financial statement.

(c) whether components of other comprehensive income should be reclassified to profit or loss and, if so, the characteristics of the transactions and events that should be reclassified and when reclassification should be made.

(d) whether the direct or the indirect method of presenting operating cash flows provides more useful information.

BC9 In March 2006, as a result of its work in phase A, the Board published an exposure draft of proposed amendments to IAS 1—*A Revised Presentation*. The Board received more than 130 comment letters. The exposure draft proposed amendments that affected the presentation of owner changes in equity and the presentation of comprehensive income, but did not propose to change the recognition, measurement or disclosure of specific transactions and other events required by other IFRSs. It also proposed to bring IAS 1 largely into line with the US standard—SFAS 130 *Reporting Comprehensive Income*. After considering the responses to the exposure draft the Board issued a revised version of IAS 1. The FASB decided to consider phases A and B issues together, and therefore did not publish an exposure draft on phase A.

BC10 The following sections summarise the Board's considerations in reaching its conclusions as part of its revision in 2007:

(a) general purpose financial statements (paragraphs BC11–BC13)

(b) titles of financial statements (paragraphs BC14–BC21)

(c) equal prominence (paragraph BC22)

(d) a statement of financial position as at the beginning of the earliest comparative period (paragraphs BC31 and BC32)

(e) IAS 34 *Interim Financial Reporting* (paragraph BC33)

(f) reporting owner and non-owner changes in equity (paragraphs BC37 and BC38)

(g) reporting comprehensive income (paragraphs BC49–BC54)

(h) subtotal for profit or loss (paragraphs BC57 and BC58)

(i) other comprehensive income-related tax effects (paragraphs BC65– BC68)

(j) reclassification adjustments (paragraphs BC69–BC73)

(k) effects of retrospective application or retrospective restatement (paragraph BC74)

(l) presentation of dividends (paragraph BC75)

(m) IAS 7 *Cash Flow Statements* (paragraph BC76)

(n) presentation of measures per share (paragraphs BC101–BC104)

(o) effective date and transition (paragraph BC105)

(p) differences from SFAS 130 (paragraph BC106).

Definitions

General purpose financial statements (paragraph 7)

BC11 The exposure draft of 2006 proposed a change to the explanatory paragraph of what 'general purpose financial statements' include, in order to produce a more generic definition of a set of financial statements. Paragraph 7 of the exposure draft stated:

> General purpose financial statements include those that are presented separately or within other *public* documents such as a *regulatory filing* or report to shareholders. [emphasis added]

BC12 Respondents expressed concern about the proposed change. They argued that it could be understood as defining as general purpose financial statements any financial statement or set of financial statements filed with a regulator and could capture documents other than annual reports and prospectuses. They saw this change as expanding the scope of IAS 1 to documents that previously would not have contained all of the disclosures required by IAS 1. Respondents pointed out that the change would particularly affect some entities (such as small private companies and subsidiaries of public companies with no external users of financial reports) that are required by law to place their financial statements on a public file.

BC13 The Board acknowledged that in some countries the law requires entities, whether public or private, to report to regulatory authorities and include information in those reports that could be beyond the scope of IAS 1. Because the Board did not intend to extend the definition of general purpose financial statements, it decided to eliminate the explanatory paragraph of what 'general purpose financial statements' include, while retaining the definition of 'general purpose financial statements'.

Financial statements

Complete set of financial statements

Titles of financial statements (paragraph 10)

BC14 The exposure draft of 2006 proposed changes to the titles of some of the financial statements—from 'balance sheet' to 'statement of financial position', from 'income statement' to 'statement of profit or loss' and from 'cash flow statement' to 'statement of cash flows'. In addition, the exposure draft proposed a 'statement of recognised income and expense' and that all owner changes in equity should be included in a 'statement of changes in equity'. The Board did not propose to make any of these changes of nomenclature mandatory.

BC15 Many respondents opposed the proposed changes, pointing out that the existing titles had a long tradition and were well understood. However, the Board reaffirmed its view that the proposed new titles better reflect the function of each financial statement, and pointed out that an entity could choose to use other titles in its financial report.

BC16 The Board reaffirmed its conclusion that the title 'statement of financial position' not only better reflects the function of the statement but is consistent with the *Framework for the Preparation and Presentation of Financial Statements*, which contains several references to 'financial position'. Paragraph 12 of the *Framework*[*] states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity; paragraph 19 of the *Framework* states that information about financial position is primarily provided in a balance sheet. In the Board's view, the title 'balance sheet' simply reflects that double entry bookkeeping requires debits to equal credits. It does not identify the content or purpose of the statement. The Board also noted that 'financial position' is a well-known and accepted term, as it has been used in auditors' opinions internationally for more than 20 years to describe what the 'balance sheet' presents. The Board decided that aligning the statement's title with its content and the opinion rendered by the auditor would help the users of financial statements.

BC17 As to the other statements, respondents suggested that renaming the balance sheet the 'statement of financial position' implied that the 'cash flow statement' and the 'statement of recognised income and expense' do not also reflect an entity's financial position. The Board observed that although the latter statements reflect changes in an entity's financial position, neither can be called a 'statement of changes in financial position', as this would not depict their true function and objective (ie to present cash flows and performance, respectively). The Board acknowledged that the titles 'income statement' and 'statement of profit or loss' are similar in meaning and could be used interchangeably, and decided to retain the title 'income statement' as this is more commonly used.

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

BC18 The title of the proposed new statement, the 'statement of recognised income and expense', reflects a broader content than the former 'income statement'. The statement encompasses both income and expenses recognised in profit or loss and income and expenses recognised outside profit or loss.

BC19 Many respondents opposed the title 'statement of recognised income and expense', objecting particularly to the use of the term 'recognised'. The Board acknowledged that the term 'recognised' could also be used to describe the content of other primary statements as 'recognition', explained in paragraph 82 of the *Framework*, is 'the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 83.' Many respondents suggested the term 'statement of comprehensive income' instead.

BC20 In response to respondents' concerns and to converge with SFAS 130, the Board decided to rename the new statement a 'statement of comprehensive income'. The term 'comprehensive income' is not defined in the *Framework* but is used in IAS 1 to describe the change in equity of an entity during a period from transactions, events and circumstances other than those resulting from transactions with owners in their capacity as owners. Although the term 'comprehensive income' is used to describe the aggregate of all components of comprehensive income, including profit or loss, the term 'other comprehensive income' refers to income and expenses that under IFRSs are included in comprehensive income but excluded from profit or loss.

BC20A In May 2010 the Board published the exposure draft *Presentation of Items of Other Comprehensive Income* (proposed amendments to IAS 1) relating to the presentation of items of other comprehensive income (OCI). One of the proposals in the exposure draft related to the title of the statement containing profit or loss and other comprehensive income. The Board proposed this change so that it would be clear that the statement had two components: profit or loss and other comprehensive income. A majority of the respondents to the exposure draft supported the change and therefore the Board confirmed the proposal in June 2011. IAS 1 allows preparers to use other titles for the statement that reflect the nature of their activities.

BC20B Several other IFRSs refer to the 'statement of comprehensive income'. The Board considered whether it should change all such references to 'statement of profit or loss and other comprehensive income'. The Board noted that the terminology used in IAS 1 is not mandatory and that 'statement of comprehensive income' is one of the examples used in the standard. The Board decided that there was little benefit in replacing the title 'statement of comprehensive income' in other IFRSs or 'income statement' with the 'statement of profit or loss'. However, the Board did change the terminology when an IFRS made reference to the two-statement option.

BC21 In finalising its revision, the Board confirmed that the titles of financial statements used in this Standard would not be mandatory. The titles will be used in future IFRSs but are not required to be used by entities in their financial statements. Some respondents to the exposure draft expressed concern that non-mandatory titles will result in confusion. However, the Board believes that making use of the titles non-mandatory will allow time for entities to implement changes gradually as the new titles become more familiar.

Equal prominence (paragraphs 11 and 12)

BC22 The Board noted that the financial performance of an entity is not assessed by reference to a single financial statement or a single measure within a financial statement. The Board believes that the financial performance of an entity can be assessed only after all aspects of the financial statements are taken into account and understood in their entirety. Accordingly, the Board decided that in order to help users of the financial statements to understand the financial performance of an entity comprehensively, all financial statements within the complete set of financial statements should be presented with equal prominence.

Departures from IFRSs (paragraphs 19–24)

BC23 IAS 1 (as issued in 1997) permitted an entity to depart from a requirement in a Standard 'in the extremely rare circumstances when management concludes that compliance with a requirement in a Standard would be misleading, and therefore that departure from a requirement is necessary to achieve a fair presentation' (paragraph 17, now paragraph 19). When such a departure occurred, paragraph 18 (now paragraph 20) required extensive disclosure of the facts and circumstances surrounding the departure and the treatment adopted.

BC24 The Board decided to clarify in paragraph 15 of the Standard that for financial statements to present fairly the financial position, financial performance and cash flows of an entity, they must represent faithfully the effects of transactions and other events in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*.

BC25 The Board decided to limit the occasions on which an entity should depart from a requirement in an IFRS to the extremely rare circumstances in which management concludes that compliance with the requirement would be so misleading that it would conflict with the objective of financial statements set out in the *Framework*. Guidance on this criterion states that an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events or conditions that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to influence economic decisions made by users of financial statements.

BC26 These amendments provide a framework within which an entity assesses how to present fairly the effects of transactions, other events and conditions, and whether the result of complying with a requirement in an IFRS would be so misleading that it would not give a fair presentation.

BC27 The Board considered whether IAS 1 should be silent on departures from IFRSs. The Board decided against making that change, because it would remove the Board's capability to specify the criteria under which departures from IFRSs should occur.

BC28 Departing from a requirement in an IFRS when considered necessary to achieve a fair presentation would conflict with the regulatory framework in some jurisdictions. The revised IAS 1 takes into account the existence of different regulatory requirements. It requires that when an entity's circumstances satisfy the criterion described in paragraph BC25 for departure from a requirement in an IFRS, the entity should proceed as follows:

(a) When the relevant regulatory framework requires—or otherwise does not prohibit—a departure from the requirement, the entity should make that departure and the disclosures set out in paragraph 20.

(b) When the relevant regulatory framework prohibits departure from the requirement, the entity should, to the maximum extent possible, reduce the perceived misleading aspects of compliance by making the disclosures set out in paragraph 23.

This amendment enables entities to comply with the requirements of IAS 1 when the relevant regulatory framework prohibits departures from accounting standards, while retaining the principle that entities should, to the maximum extent possible, ensure that financial statements provide a fair presentation.

BC29 After considering the comments received on the exposure draft of 2002, the Board added to IAS 1 a requirement in paragraph 21 to disclose the effect of a departure from a requirement of an IFRS in a prior period on the current period's financial statements. Without this disclosure, users of the entity's financial statements could be unaware of the continuing effects of prior period departures.

BC30 In view of the strict criteria for departure from a requirement in an IFRS, IAS 1 includes a rebuttable presumption that if other entities in similar circumstances comply with the requirement, the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the *Framework*.

Comparative information

A statement of financial position as at the beginning of the earliest comparative period (paragraph 39)

BC31 The exposure draft of 2006 proposed that a statement of financial position as at the beginning of the earliest comparative period should be presented as part of a complete set of financial statements. This statement would provide a basis for investors and creditors to evaluate information about the entity's performance during the period. However, many respondents expressed concern that the requirement would unnecessarily increase disclosures in financial statements, or would be impracticable, excessive and costly.

BC32 By adding a statement of financial position as at the beginning of the earliest comparative period, the exposure draft proposed that an entity should present three statements of financial position and two of each of the other statements. Considering that financial statements from prior years are readily available for financial analysis, the Board decided to require only two statements of financial position, except when the financial statements have been affected by retrospective application or retrospective restatement, as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, or when a reclassification has been made. In those circumstances three statements of financial position are required.

Clarification of requirements for comparative information

BC32A In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board addressed a request to clarify the requirements for providing comparative information for:

(a) the comparative requirements for the opening statement of financial position when an entity changes accounting policies, or makes retrospective restatements or reclassifications, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and

(b) the requirements for providing comparative information when an entity provides financial statements beyond the minimum comparative information requirements.

Opening statement of financial position

BC32B In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board addressed a request to clarify the appropriate date for the opening statement of financial position. The Board decided to amend the current requirements in IAS 1 that relate to the presentation of a statement of financial position for the beginning of the earliest comparative period presented in cases of changes in accounting policies, retrospective restatements or reclassifications to clarify that the appropriate date for the opening statement of financial position is the beginning of the preceding period.

BC32C The Board also decided to change the previous requirements so that related notes to this opening statement of financial position are no longer required to be presented. The Board's decision to give this relief was based on the fact that circumstances in which an entity changes an accounting policy, or makes a retrospective restatement or a reclassification in accordance with IAS 8, are considered narrow, specific and limited. However, the circumstances in which an entity chooses to provide additional financial statements (ie on a voluntary basis) can be viewed as more generic and may arise for different reasons. Accordingly, this relief is not available when additional financial statements are provided on a voluntary basis.

BC32D The Board added the guidance in paragraph 40A(a) to clarify when an opening statement of financial position provides useful information and, should therefore be required. Paragraph 40A(b) is a reminder that the concept of materiality should be considered in applying the guidance in paragraph 40A(a). The Board noted that the entity would still be required to disclose the information required by IAS 8 for changes in accounting policies and retrospective restatements.

Comparative information beyond minimum requirements

BC32E In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board addressed a request to clarify the requirements for providing comparative information. Specifically, the Board was asked to consider whether an entity should be required to present a complete set of financial statements when it provides financial statements beyond the minimum comparative information requirements (ie additional comparative information). In response to this request, the Board decided to clarify that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum requirements. The Board also noted that additional comparative information might include:

(a) information that is presented voluntarily, beyond the information that is included within a complete set of financial statements; or

(b) comparative information that is required by law or other regulations but that is not required by IFRSs.

BC32F The Board also decided to amend paragraphs 38–41 of IAS 1 to clarify that, when additional comparative information (that is not required by IFRSs) is provided by an entity, this information should be presented in accordance with IFRSs and the entity should present comparative information in the related notes for that additional information. The Board determined that requiring full notes for additional information in accordance with paragraph 38C is necessary to ensure that the additional information that the entity provides is balanced and results in financial statements that achieve a fair presentation.

BC32G In the light of the concerns raised by interested parties, the Board decided that the amendments should be introduced through the Annual Improvements process instead of through the Financial Statement Presentation project, so that the changes could be made more quickly.

IAS 34 *Interim Financial Reporting*

BC33 The Board decided not to reflect in paragraph 8 of IAS 34 (ie the minimum components of an interim financial report) its decision to require the inclusion of a statement of financial position as at the beginning of the earliest comparative period in a complete set of financial statements. IAS 34 has a year-to-date approach to interim reporting and does not replicate the requirements of IAS 1 in terms of comparative information.

Criterion for exemption from requirements (paragraphs 41–44)

BC34 IAS 1 as issued in 1997 specified that when the presentation or classification of items in the financial statements is amended, comparative amounts should be reclassified unless it is impracticable to do so. Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

BC35 The exposure draft of 2002 proposed a different criterion for exemption from particular requirements. For the reclassification of comparative amounts, and its proposed new requirement to disclose key assumptions and other sources of estimation uncertainty at the end of the reporting period (discussed in paragraphs BC79–BC84), the exposure draft proposed that the criterion for exemption should be that applying the requirements would require undue cost or effort.

BC36 In the light of respondents' comments on the exposure draft, the Board decided that an exemption based on management's assessment of undue cost or effort was too subjective to be applied consistently by different entities. Moreover, balancing costs and benefits was a task for the Board when it sets accounting requirements rather than for entities when they apply them. Therefore, the Board retained the 'impracticability' criterion for exemption. This affects the exemptions now set out in paragraphs 41–43 and 131 of IAS 1. Impracticability is the only basis on which IFRSs allow specific exemptions from applying particular requirements when the effect of applying them is material*.

Reporting owner and non-owner changes in equity

BC37 The exposure draft of 2006 proposed to separate changes in equity of an entity during a period arising from transactions with owners in their capacity as owners (ie all owner changes in equity) from other changes in equity (ie non-owner changes in equity). All owner changes in equity would be presented in the statement of changes in equity, separately from non-owner changes in equity.

BC38 Most respondents welcomed this proposal and saw this change as an improvement of financial reporting, by increasing the transparency of those items recognised in equity that are not reported as part of profit or loss. However, some respondents pointed out that the terms 'owner' and 'non-owner' were not defined in the exposure draft, the *Framework* or elsewhere in IFRSs, although they are extensively used in national accounting standards. They also noted that the terms 'owner' and 'equity holder' were used interchangeably in the exposure draft. The Board decided to adopt the term 'owner' and use it throughout IAS 1 to converge with SFAS 130, which uses the term in the definition of 'comprehensive income'.

Statement of financial position

Current assets and current liabilities (paragraphs 68 and 71)

BC38A As part of its improvements project in 2007, the Board identified inconsistent guidance regarding the current/non-current classification of derivatives. Some might read the guidance included in paragraph 71 as implying that financial liabilities classified as held for trading in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* are always required to be presented as current.

BC38B The Board expects the criteria set out in paragraph 69 to be used to assess whether a financial liability should be presented as current or non-current. The 'held for trading' category in paragraph 9 of IAS 39 is for measurement purposes and includes financial assets and liabilities that may not be held primarily for trading purposes.

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

BC38C The Board reaffirmed that if a financial liability is held primarily for trading purposes it should be presented as current regardless of its maturity date. However, a financial liability that is not held for trading purposes, such as a derivative that is not a financial guarantee contract or a designated hedging instrument, should be presented as current or non-current on the basis of its settlement date. For example, derivatives that have a maturity of more than twelve months and are expected to be held for more than twelve months after the reporting period should be presented as non-current assets or liabilities.

BC38D Therefore, the Board decided to remove the identified inconsistency by amending the examples of current liabilities in paragraph 71. The Board also amended paragraph 68 in respect of current assets to remove a similar inconsistency.

Classification of the liability component of a convertible instrument (paragraph 69)

BC38E As part of its improvements project in 2007, the Board considered the classification of the liability component of a convertible instrument as current or non-current. Paragraph 69(d) of IAS 1 states that when an entity does not have an unconditional right to defer settlement of a liability for at least twelve months after the reporting period, the liability should be classified as current. According to the *Framework*, conversion of a liability into equity is a form of settlement.

BC38F The application of these requirements means that if the conversion option can be exercised by the holder at any time, the liability component would be classified as current. This classification would be required even if the entity would not be required to settle unconverted instruments with cash or other assets for more than twelve months after the reporting period.

BC38G IAS 1 and the *Framework* state that information about the liquidity and solvency positions of an entity is useful to users. The terms ‘liquidity’ and ‘solvency’ are associated with the availability of cash to an entity. Issuing equity does not result in an outflow of cash or other assets of the entity.

BC38H The Board concluded that classifying the liability on the basis of the requirements to transfer cash or other assets rather than on settlement better reflects the liquidity and solvency position of an entity, and therefore it decided to amend IAS 1 accordingly.

BC38I The Board discussed the comments received in response to its exposure draft of proposed *Improvements to IFRSs* published in 2007 and noted that some respondents were concerned that the proposal in the exposure draft would apply to all liabilities, not just those that are components of convertible instruments as originally contemplated in the exposure draft. Consequently, in *Improvements to IFRSs* issued in April 2009, the Board amended the proposed wording to clarify that the amendment applies only to the classification of a liability that can, at the option of the counterparty, be settled by the issue of the entity’s equity instruments.

Effect of events after the reporting period on the classification of liabilities (paragraphs 69–76)

BC39 Paragraph 63 of IAS 1 (as issued in 1997) included the following:

> An enterprise should continue to classify its long-term interest-bearing liabilities as non-current, even when they are due to be settled within twelve months of the balance sheet date if:
>
> (a) the original term was for a period of more than twelve months;
>
> (b) the enterprise intends to refinance the obligation on a long-term basis; and
>
> (c) that intention is supported by an agreement to refinance, or to reschedule payments, which is completed before the financial statements are authorised for issue.

BC40 Paragraph 65 stated:

> Some borrowing agreements incorporate undertakings by the borrower (covenants) which have the effect that the liability becomes payable on demand if certain conditions related to the borrower's financial position are breached. In these circumstances, the liability is classified as non-current only when:
>
> (a) the lender has agreed, prior to the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach; and
>
> (b) it is not probable that further breaches will occur within twelve months of the balance sheet date.

BC41 The Board considered these requirements and concluded that refinancing, or the receipt of a waiver of the lender's right to demand payment, that occurs after the reporting period should not be taken into account in the classification of a liability.

BC42 Therefore, the exposure draft of 2002 proposed:

(a) to amend paragraph 63 to specify that a long-term financial liability due to be settled within twelve months of the balance sheet date should not be classified as a non-current liability because an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue. This amendment would not affect the classification of a liability as non-current when the entity has, under the terms of an existing loan facility, the discretion to refinance or roll over its obligations for at least twelve months after the balance sheet date.

(b) to amend paragraph 65 to specify that a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach. However, if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during which the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

   (i) the entity rectifies the breach within the period of grace; or

   (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.

BC43 Some respondents disagreed with these proposals. They advocated classifying a liability as current or non-current according to whether it is expected to use current assets of the entity, rather than strictly on the basis of its date of maturity and whether it is callable at the end of the reporting period. In their view, this would provide more relevant information about the liability's future effect on the timing of the entity's resource flows.

BC44 However, the Board decided that the following arguments for changing paragraphs 63 and 65 were more persuasive:

(a) refinancing a liability after the balance sheet date does not affect the entity's liquidity and solvency *at the balance sheet date*, the reporting of which should reflect contractual arrangements in force on that date. Therefore, it is a non-adjusting event in accordance with IAS 10 *Events after the Balance Sheet Date* and should not affect the presentation of the entity's balance sheet.

(b) it is illogical to adopt a criterion that 'non-current' classification of short-term obligations expected to be rolled over for at least twelve months after the balance sheet date depends on whether the rollover is at the discretion of the entity, and then to provide an exception based on refinancing occurring after the balance sheet date.

(c) in the circumstances set out in paragraph 65, unless the lender has waived its right to demand immediate repayment or granted a period of grace within which the entity may rectify the breach of the loan agreement, the financial condition of the entity at the balance sheet date was that the entity did not hold an absolute right to defer repayment, based on the terms of the loan agreement. The granting of a waiver or a period of grace changes the terms of the loan agreement. Therefore, an entity's receipt from the lender, after the balance sheet date, of a waiver or a period of grace of at least twelve months does not change the nature of the liability to non-current until it occurs.

BC45 IAS 1 now includes the amendments proposed in 2002, with one change. The change relates to the classification of a long-term loan when, at the end of the reporting period, the lender has provided a period of grace within which a breach of the loan agreement can be rectified, and during which period the lender cannot demand immediate repayment of the loan.

BC46 The exposure draft proposed that such a loan should be classified as non-current if it is due for settlement, without the breach, at least twelve months after the balance sheet date and:

(a) the entity rectifies the breach within the period of grace; or

(b) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.

BC47 After considering respondents' comments, the Board decided that the occurrence or probability of a rectification of a breach after the reporting period is irrelevant to the conditions existing at the end of the reporting period. The revised IAS 1 requires that, for the loan to be classified as non-current, the period of grace must end at least twelve months after the reporting period (see paragraph 75). Therefore, the conditions (a) and (b) in paragraph BC46 are redundant.

BC48 The Board considered arguments that if a period of grace to remedy a breach of a long-term loan agreement is provided before the end of the reporting period, the loan should be classified as non-current regardless of the length of the period of grace. These arguments are based on the view that, at the end of the reporting period, the lender does not have an unconditional legal right to demand repayment before the original maturity date (ie if the entity remedies the breach during the period of grace, it is entitled to repay the loan on the original maturity date). However, the Board concluded that an entity should classify a loan as non-current only if it has an unconditional right to defer settlement of the loan for at least twelve months after the reporting period. This criterion focuses on the legal rights of the entity, rather than those of the lender.

Statement of comprehensive income

Reporting comprehensive income (paragraph 81)

BC49 The exposure draft of 2006 proposed that all non-owner changes in equity should be presented in a single statement or in two statements. In a single-statement presentation, all items of income and expense are presented together. In a two-statement presentation, the first statement ('income statement') presents income and expenses recognised in profit or loss and the second statement ('statement of comprehensive income') begins with profit or loss and presents, in addition, items of income and expense that IFRSs require or permit to be recognised outside profit or loss. Such items include, for example, translation differences related to foreign operations and gains or losses on available-for-sale financial assets. The statement of comprehensive income does not include transactions with owners in their capacity as owners. Such transactions are presented in the statement of changes in equity.

BC50 Respondents to the exposure draft had mixed views about whether the Board should permit a choice of displaying non-owner changes in equity in one statement or two statements. Many respondents agreed with the Board's proposal to maintain the two-statement approach and the single-statement approach as alternatives and a few urged the Board to mandate one of them. However, most respondents preferred the two-statement approach because it distinguishes profit or loss and total comprehensive income; they believe that with the two-statement approach, the 'income statement' remains a primary financial statement. Respondents supported the presentation of two separate statements as a transition measure until the Board develops principles to determine the criteria for inclusion of items in profit or loss or in other comprehensive income.

BC51 The exposure draft of 2006 expressed the Board's preference for a single statement of all non-owner changes in equity. The Board provided several reasons for this preference. All items of non-owner changes in equity meet the definitions of income and expenses in the *Framework*. The *Framework* does not define profit or loss, nor does it provide criteria for distinguishing the characteristics of items that should be included in profit or loss from those items that should be excluded from profit or loss. Therefore, the Board decided that it was conceptually correct for an entity to present all non-owner changes in equity (ie all income and expenses recognised in a period) in a single statement because there are no clear principles or common characteristics that can be used to separate income and expenses into two statements.

BC52 However, in the Board's discussions with interested parties, it was clear that many were strongly opposed to the concept of a single statement. They argued that there would be undue focus on the bottom line of the single statement. In addition, many argued that it was premature for the Board to conclude that presentation of income and expense in a single statement was an improvement in financial reporting without also addressing the other aspects of presentation and display, namely deciding what categories and line items should be presented in a statement of recognised income and expense.

BC53 In the light of these views, although it preferred a single statement, the Board decided that an entity should have the choice of presenting all income and expenses recognised in a period in one statement or in two statements. An entity is prohibited from presenting components of income and expense (ie non-owner changes in equity) in the statement of changes in equity.

BC54 Many respondents disagreed with the Board's preference and thought that a decision at this stage would be premature. In their view the decision about a single-statement or two-statement approach should be subject to further consideration. They urged the Board to address other aspects of presentation and display, namely deciding which categories and line items should be presented in a 'statement of comprehensive income'. The Board reaffirmed its reasons for preferring a single-statement approach and agreed to address other aspects of display and presentation in the next stage of the project.

BC54A In *Presentation of Items of Other Comprehensive Income* published in May 2010 the Board proposed to eliminate the option to present all items of income and expense recognised in a period in two statements, thereby requiring presentation in a continuous statement displaying two sections: *profit or loss* and *other comprehensive income*. The Board also proposed to require items of OCI to be classified into items that might be reclassified (recycled) to profit or loss in subsequent periods and items that would not be reclassified subsequently.

BC54B In its deliberations on financial instruments and pensions the Board discussed the increasing importance of consistent presentation of items of OCI. Both projects will increase the number of items presented in OCI, particularly items that will not be reclassified subsequently to profit or loss. Therefore the Board thought it important that all income and expenses that are components of the total non-owner changes in equity should be presented transparently.

BC54C The Board has no plans to eliminate profit or loss as a measure of performance. Profit or loss will be presented separately and will remain the required starting point for the calculation of earnings per share.

BC54D The Board had previously received responses to similar proposals for a single statement of comprehensive income. In October 2008 the Board and the FASB jointly published a discussion paper, *Preliminary Views on Financial Statement Presentation*. In that paper, the boards proposed eliminating the alternative presentation formats for comprehensive income and to require an entity to present comprehensive income and its components in a single statement. The boards asked for views on that proposal. The responses were split on whether an entity should present comprehensive income and its components in a single statement or in two separate statements. In general, respondents supporting a single statement of comprehensive income said that it would lead to greater transparency, consistency and comparability. Furthermore, the process of calculating financial ratios would be made easier.

BC54E Respondents disagreeing with the proposal for a single statement of comprehensive income urged the boards to defer any changes to the guidance on the statement of comprehensive income until the boards had completed a project to revise the guidance on what items should be presented in OCI. Those respondents also said that a single statement would undermine the importance of profit or loss by making it a subtotal and that presenting total comprehensive income as the last number in the statement would confuse users. They also feared that requiring all items of income and expense to be presented in a single statement was the first step by the boards towards eliminating the notion of profit or loss. In addition, they argued that the items that are presented in OCI are different from items presented in profit or loss. Therefore they preferred either to keep the presentation of profit or loss separate from the presentation of OCI or to allow management to choose to present them either in a single statement or in two statements.

BC54F In the responses to the exposure draft of May 2010 many of the respondents objected to the proposals to remove the option to present all items of income and expense in two statements. The arguments used by those objecting were much the same as those received on the discussion paper. However, many respondents, regardless of their views on the proposed amendments, said that the Board should establish a conceptual basis for what should be presented in OCI. Those opposed to a continuous statement cited OCI's lack of a conceptual definition and therefore believed that OCI should not be presented in close proximity to profit or loss because this would confuse users. However, users generally said that the lack of a conceptual framework made it difficult to distinguish the underlying economics of items reported in profit or loss (net income) from items reported in other comprehensive income. Although users also asked for a conceptual framework for OCI, most supported the notion of a single statement of comprehensive income.

BC54G Another issue on which many respondents commented was the reclassification (recycling) of OCI items. Those respondents said that in addition to addressing the conceptual basis for the split between profit or loss and OCI the Board should set principles for which OCI items should be reclassified (recycled) to profit or loss and when they should be reclassified. The Board acknowledges that it has not set out a conceptual basis for how it determines whether an item should be presented in OCI or in profit or loss. It also agrees that it has not set out principles to determine whether items should be reclassified to profit or loss. Those matters were not within the scope of this project, which focused on presentation, and therefore the Board has not addressed them at this time. However, the Board is consulting on its future agenda, which could lead to those matters becoming part of the work programme.

BC54H In the light of the response the Board confirmed in June 2011 the requirement for items of OCI to be classified into items that will not be reclassified (recycled) to profit or loss in subsequent periods and items that might be reclassified.

BC54I The Board also decided not to mandate the presentation of profit or loss in a continuous statement of profit or loss and other comprehensive income but to maintain an option to present two statements. The Board did this in the light of the negative response to its proposal for a continuous statement and the resistance to this change signified by a majority of respondents.

BC54J The FASB also proposed in its exposure draft to mandate a continuous statement of comprehensive income but decided in the light of the responses not to go as far as mandating a single statement and instead to allow the two-statement option. Nevertheless, the changes made by the FASB are a significant improvement for US GAAP, which previously allowed an option to present OCI items in stockholders' equity or in the notes to the financial statements.

Results of operating activities

BC55 IAS 1 omits the requirement in the 1997 version to disclose the results of operating activities as a line item in the income statement. 'Operating activities' are not defined in IAS 1, and the Board decided not to require disclosure of an undefined item.

BC56 The Board recognises that an entity may elect to disclose the results of operating activities, or a similar line item, even though this term is not defined. In such cases, the Board notes that the entity should ensure that the amount disclosed is representative of activities that would normally be regarded as 'operating'. In the Board's view, it would be misleading and would impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities, even if that had been industry practice. For example, it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently or are unusual in amount. Similarly, it would be inappropriate to exclude items on the grounds that they do not involve cash flows, such as depreciation and amortisation expenses.

Subtotal for profit or loss (paragraph 82)

BC57 As revised, IAS 1 requires a subtotal for profit or loss in the statement of comprehensive income. If an entity chooses to present comprehensive income by using two statements, it should begin the second statement with profit or loss—the bottom line of the first statement (the 'income statement')—and display the components of other comprehensive income immediately after that. The Board concluded that this is the best way to achieve the objective of equal prominence (see paragraph BC22) for the presentation of income and expenses. An entity that chooses to display comprehensive income in one statement should include profit or loss as a subtotal within that statement.

BC58 The Board acknowledged that the items included in profit or loss do not possess any unique characteristics that allow them to be distinguished from items that are included in other comprehensive income. However, the Board and its predecessor have required some items to be recognised outside profit or loss. The Board will deliberate in the next stage of the project how items of income and expense should be presented in the statement of comprehensive income.

Minority interest (paragraph 83)*

BC59 IAS 1 requires the 'profit or loss attributable to minority interest' and 'profit or loss attributable to owners of the parent' each to be presented in the income statement in accordance with paragraph 83. These amounts are to be presented as allocations of profit or loss, not as items of income or expense. A similar requirement has been added for the statement of changes in equity, in paragraph 106(a). These changes are consistent with IAS 27 *Consolidated and Separate Financial Statements*, which requires that in a consolidated balance sheet (now called 'statement of financial position'), minority interest is presented within equity because it does not meet the definition of a liability in the *Framework*.

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

Extraordinary items (paragraph 87)

BC60 IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* (issued in 1993) required extraordinary items to be disclosed in the income statement separately from the profit or loss from ordinary activities. That standard defined 'extraordinary items' as 'income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly'.

BC61 In 2002, the Board decided to eliminate the concept of extraordinary items from IAS 8 and to prohibit the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes. Therefore, in accordance with IAS 1, no items of income and expense are to be presented as arising from outside the entity's ordinary activities.

BC62 Some respondents to the exposure draft of 2002 argued that extraordinary items should be presented in a separate component of the income statement because they are clearly distinct from all of the other items of income and expense, and because such presentation highlights to users of financial statements the items of income and expense to which the least attention should be given when predicting an entity's future performance.

BC63 The Board decided that items treated as extraordinary result from the normal business risks faced by an entity and do not warrant presentation in a separate component of the income statement. The nature or function of a transaction or other event, rather than its frequency, should determine its presentation within the income statement. Items currently classified as 'extraordinary' are only a subset of the items of income and expense that may warrant disclosure to assist users in predicting an entity's future performance.

BC64 Eliminating the category of extraordinary items eliminates the need for arbitrary segregation of the effects of related external events—some recurring and others not—on the profit or loss of an entity for a period. For example, arbitrary allocations would have been necessary to estimate the financial effect of an earthquake on an entity's profit or loss if it occurs during a major cyclical downturn in economic activity. In addition, paragraph 97 of IAS 1 requires disclosure of the nature and amount of material items of income and expense.

Other comprehensive income—related tax effects (paragraphs 90 and 91)

BC65 The exposure draft of 2006 proposed to allow components of 'other recognised income and expense' (now 'other comprehensive income') to be presented before tax effects ('gross presentation') or after their related tax effects ('net presentation'). The 'gross presentation' facilitated the traceability of other comprehensive income items to profit or loss, because items of profit or loss are generally displayed before tax. The 'net presentation' facilitated the identification of other comprehensive income Items in the equity section of the statement of financial position. A majority of respondents supported allowing both approaches. The Board reaffirmed its conclusion that components of other comprehensive income could be displayed either (a) net of related tax effects or (b) before related tax effects.

BC66 Regardless of whether a pre-tax or post-tax display was used, the exposure draft proposed to require disclosure of the amount of income tax expense or benefit allocated separately to individual components of other comprehensive income, in line with SFAS 130. Many respondents agreed in principle with this disclosure, because they agreed that it helped to improve the clarity and transparency of such information, particularly when components of other comprehensive income are taxed at rates different from those applied to profit or loss.

BC67 However, most respondents expressed concern about having to trace the tax effect for each one of the components of other comprehensive income. Several observed that the tax allocation process is arbitrary (eg it may involve the application of subjectively determined tax rates) and some pointed out that this information is not readily available for some industries (eg the insurance sector), where components of other comprehensive income are multiple and tax allocation involves a high degree of subjectivity. Others commented that they did not understand why tax should be attributed to components of comprehensive income line by line, when this is not a requirement for items in profit or loss.

BC68 The Board decided to maintain the disclosure of income tax expense or benefit allocated to each component of other comprehensive income. Users of financial statements often requested further information on tax amounts relating to components of other comprehensive income, because tax rates often differed from those applied to profit or loss. The Board also observed that an entity should have such tax information available and that a disclosure requirement would therefore not involve additional cost for preparers of financial statements.

BC68A In its exposure draft *Presentation of Items of Other Comprehensive Income* published in May 2010 the Board proposed requiring that income tax on items presented in OCI should be allocated between items that will not be subsequently reclassified to profit or loss and those that might be reclassified, if the items in OCI are presented before tax. Most respondents agreed with this proposal as this would be in line with the existing options in IAS 1 regarding presentation of income tax on OCI items. Therefore the Board confirmed the proposal in June 2011.

Reclassification adjustments (paragraphs 92–96)

BC69 In the exposure draft of 2006, the Board proposed that an entity should separately present reclassification adjustments. These adjustments are the amounts reclassified to profit or loss in the current period that were previously recognised in other comprehensive income. The Board decided that adjustments necessary to avoid double-counting items in total comprehensive income when those items are reclassified to profit or loss in accordance with IFRSs. The Board's view was that separate presentation of reclassification adjustments is essential to inform users of those amounts that are included as income and expenses in different periods—as income or expenses in other comprehensive income in previous periods and as income or expenses in profit or loss in the current period. Without such information, users may find it difficult to assess the effect of reclassifications on profit or loss and to calculate the overall gain or loss associated with available-for-sale financial assets, cash flow hedges and on translation or disposal of foreign operations.

BC70 Most respondents agreed with the Board's decision and believe that the disclosure of reclassification adjustments is important to understanding how components recognised in profit or loss are related to other items recognised in equity in two different periods. However, some respondents suggested that the Board should use the term 'recycling', rather than 'reclassification' as the former term is more common. The Board concluded that both terms are similar in meaning, but decided to use the term 'reclassification adjustment' to converge with the terminology used in SFAS 130.

BC71 The exposure draft proposed to allow the presentation of reclassification adjustments in the statement of recognised income and expense (now 'statement of comprehensive income') or in the notes. Most respondents supported this approach.

BC72 Some respondents noted some inconsistencies in the definition of 'reclassification adjustments' in the exposure draft (now paragraphs 7 and 93 of IAS 1). Respondents suggested that the Board should expand the definition in paragraph 7 to include gains and losses recognised in current periods in addition to those recognised in earlier periods, to make the definition consistent with paragraph 93. They commented that, without clarification, there could be differences between interim and annual reporting, for reclassifications of items that arise in one interim period and reverse out in a different interim period within the same annual period.

BC73 The Board decided to align the definition of reclassification adjustments with SFAS 130 and include an additional reference to 'current periods' in paragraph 7.

Statement of changes in equity

Effects of retrospective application or retrospective restatement (paragraph 106(b))

BC74 Some respondents to the exposure draft of 2006 asked the Board to clarify whether the effects of retrospective application or retrospective restatement, as defined in IAS 8, should be regarded as non-owner changes in equity. The Board noted that IAS 1 specifies that these effects are included in the statement of changes in equity. However, the Board decided to clarify that the effects of retrospective application or retrospective restatement are not changes in equity in the period, but provide a reconciliation between the previous period's closing balance and the opening balance in the statement of changes in equity.

Reconciliation for each component of other comprehensive income (paragraphs 106(d)(ii) and 106A)

BC74A Paragraph 106(d) requires an entity to provide a reconciliation of changes in each component of equity. In *Improvements to IFRSs* issued in May 2010, the Board clarified that entities may present the required reconciliations for each component of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements.

Presentation of dividends (paragraph 107)

BC75 The Board reaffirmed its conclusion to require the presentation of dividends in the statement of changes in equity or in the notes, because dividends are distributions to owners in their capacity as owners and the statement of changes in equity presents all owner changes in equity. The Board concluded that an entity should not present dividends in the statement of comprehensive income because that statement presents non-owner changes in equity.

Statement of cash flows

IAS 7 *Cash Flow Statements* (paragraph 111)

BC76 The Board considered whether the operating section of an indirect method statement of cash flows should begin with total comprehensive income instead of profit or loss as is required by IAS 7 *Cash Flow Statements*. When components of other comprehensive income are non-cash items, they would become reconciling items in arriving at cash flows from operating activities and would add items to the statement of cash flows without adding information content. The Board concluded that an amendment to IAS 7 is not required; however, as mentioned in paragraph BC14 the Board decided to relabel this financial statement as 'statement of cash flows'.

Notes

Disclosure of the judgements that management has made in the process of applying the entity's accounting policies (paragraphs 122–124)

BC77 The revised IAS 1 requires disclosure of the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements (see paragraph 122). An example of these judgements is how management determines whether financial assets are held-to-maturity investments. The Board decided that disclosure of the most important of these judgements would enable users of financial statements to understand better how the accounting policies are applied and to make comparisons between entities regarding the basis on which managements make these judgements.

BC78 Comments received on the exposure draft of 2002 indicated that the purpose of the proposed disclosure was unclear. Accordingly, the Board amended the disclosure explicitly to exclude judgements involving estimations (which are the subject of the disclosure in paragraph 125) and added another four examples of the types of judgements disclosed (see paragraphs 123 and 124).

Disclosure of major sources of estimation uncertainty (paragraphs 125–133)

BC79 IAS 1 requires disclosure of the assumptions concerning the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. For those assets and liabilities, the proposed disclosures include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period (see paragraph 125).

BC80 Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices used to measure the following assets and liabilities, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence of inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about items such as the risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. No matter how diligently an entity estimates the carrying amounts of assets and liabilities subject to significant estimation uncertainty at the end of the reporting period, the reporting of point estimates in the statement of financial position cannot provide information about the estimation uncertainties involved in measuring those assets and liabilities and the implications of those uncertainties for the period's profit or loss.

BC81 The *Framework* states that 'The economic decisions that are made by users of financial statements require an evaluation of the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation.' The Board decided that disclosure of information about assumptions and other major sources of estimation uncertainty at the end of the reporting period enhances the relevance, reliability and understandability of the information reported in financial statements. These assumptions and other sources of estimation uncertainty relate to estimates that require management's most difficult, subjective or complex judgements. Therefore, disclosure in accordance with paragraph 125 of the revised IAS 1 would be made in respect of relatively few assets or liabilities (or classes of them).

BC82 The exposure draft of 2002 proposed the disclosure of some 'sources of measurement uncertainty'. In the light of comments received that the purpose of this disclosure was unclear, the Board decided:

(a) to amend the subject of that disclosure to 'sources of estimation uncertainty at the end of the reporting period', and

(b) to clarify in the revised Standard that the disclosure does not apply to assets and liabilities measured at fair value based on recently observed market prices (see paragraph 128 of IAS 1).

BC83 When assets and liabilities are measured at fair value on the basis of recently observed market prices, future changes in carrying amounts would not result from using estimates to measure the assets and liabilities at the end of the reporting period. Using observed market prices to measure assets or liabilities obviates the need for estimates at the end of the reporting period. The market prices properly reflect the fair values at the end of the reporting period, even though future market prices could be different. The objective of fair value measurement is to reflect fair value at the measurement date, not to predict a future value[*].

BC84 IAS 1 does not prescribe the particular form or detail of the disclosures. Circumstances differ from entity to entity, and the nature of estimation uncertainty at the end of the reporting period has many facets. IAS 1 limits the scope of the disclosures to items that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The longer the future period to which the disclosures relate, the greater the range of items that would qualify for disclosure, and the less specific are the disclosures that could be made about particular assets or liabilities. A period longer than the next financial year might obscure the most relevant information with other disclosures.

Disclosures about capital (paragraphs 134 and 135)

BC85 In July 2004 the Board published an exposure draft—ED 7 *Financial Instruments: Disclosures*. As part of that project, the Board considered whether it should require disclosures about capital.

BC86 The level of an entity's capital and how it manages capital are important factors for users to consider in assessing the risk profile of an entity and its ability to withstand unexpected adverse events. The level of capital might also affect the entity's ability to pay dividends. Consequently, ED 7 proposed disclosures about capital.

[*] IFRS 13 *Fair Value Measurement*, issued in May 2011, defined fair value and contains the requirements for measuring fair value.

BC87 In ED 7 the Board decided that it should not limit the requirements for disclosures about capital to entities that are subject to external capital requirements (eg regulatory capital requirements established by legislation or other regulation). The Board believes that information about capital is useful for all entities, as is evidenced by the fact that some entities set internal capital requirements and norms have been established for some industries. The Board noted that the capital disclosures are not intended to replace disclosures required by regulators. The Board also noted that the financial statements should not be regarded as a substitute for disclosures to regulators (which may not be available to all users) because the function of disclosures made to regulators may differ from the function of those to other users. Therefore, the Board decided that information about capital should be required of all entities because it is useful to users of general purpose financial statements. Accordingly, the Board did not distinguish between the requirements for regulated and non-regulated entities.

BC88 Some respondents to ED 7 questioned the relevance of the capital disclosures in an IFRS dealing with disclosures relating to financial instruments. The Board noted that an entity's capital does not relate solely to financial instruments and, thus, capital disclosures have more general relevance. Accordingly, the Board included these disclosures in IAS 1, rather than IFRS 7 *Financial Instruments: Disclosures*, the IFRS resulting from ED 7.

BC89 The Board also decided that an entity's decision to adopt the amendments to IAS 1 should be independent of the entity's decision to adopt IFRS 7. The Board noted that issuing a separate amendment facilitates separate adoption decisions.

Objectives, policies and processes for managing capital (paragraph 136)

BC90 The Board decided that disclosure about capital should be placed in the context of a discussion of the entity's objectives, policies and processes for managing capital. This is because the Board believes that such a discussion both communicates important information about the entity's capital strategy and provides the context for other disclosures.

BC91 The Board considered whether an entity can have a view of capital that differs from what IFRSs define as equity. The Board noted that, although for the purposes of this disclosure capital would often equate with equity as defined in IFRSs, it might also include or exclude some components. The Board also noted that this disclosure is intended to give entities the opportunity to describe how they view the components of capital they manage, if this is different from what IFRSs define as equity.

Externally imposed capital requirements (paragraph 136)

BC92 The Board considered whether it should require disclosure of any externally imposed capital requirements. Such a capital requirement could be:

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

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

BC93 The Board noted that some industries and countries have industry-wide capital requirements, and others do not. Thus, the Board concluded that it should not require disclosure of industry-wide requirements, or compliance with such requirements, because such disclosure would not lead to comparability between different entities or between similar entities in different countries.

BC94 The Board concluded that disclosure of the existence and level of entity-specific capital requirements is important information for users, because it informs them about the risk assessment of the regulator. Such disclosure improves transparency and market discipline.

BC95 However, the Board noted the following arguments against requiring disclosure of externally imposed entity-specific capital requirements.

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

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

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

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

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

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

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

BC96 Taking into account all of the above arguments, the Board decided not to require quantitative disclosure of externally imposed capital requirements. Rather, it decided to require disclosures about whether the entity complied with any externally imposed capital requirements during the period and, if not, the consequences of non-compliance. This retains confidentiality between regulators and the entity, but alerts users to breaches of capital requirements and their consequences.

BC97 Some respondents to ED 7 did not agree that breaches of externally imposed capital requirements should be disclosed. They argued that disclosure about breaches of externally imposed capital requirements and the associated regulatory measures subsequently imposed could be disproportionately damaging to entities. The Board was not persuaded by these arguments because it believes that such concerns indicate that information about breaches of externally imposed capital requirements may often be material by its nature. The *Framework* states that 'Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.' Similarly, the Board decided not to provide an exemption for temporary non-compliance with regulatory requirements during the year. Information that an entity is sufficiently close to its limits to breach them, even on a temporary basis, is useful for users.

Internal capital targets

BC98 The Board proposed in ED 7 that the requirement to disclose information about breaches of capital requirements should apply equally to breaches of internally imposed requirements, because it believed the information is also useful to a user of the financial statements.

BC99 However, this proposal was criticised by respondents to ED 7 for the following reasons:

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

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

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

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

BC100 As a result, the Board decided not to require disclosure of the capital targets set by management, whether the entity has complied with those targets, or the consequences of any non-compliance. However, the Board confirmed its view that when an entity has policies and processes for managing capital, qualitative disclosures about these policies and processes are useful. The Board also concluded that these disclosures, together with disclosure of the components of equity and their changes during the year (required by paragraphs 106–110), would give sufficient information about entities that are not regulated or subject to externally imposed capital requirements.

Puttable financial instruments and obligations arising on liquidation

BC100A The Board decided to require disclosure of information about puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation that are reclassified in accordance with paragraphs 16E and 16F of IAS 32. This is because the Board concluded that this disclosure allows users of financial statements to understand the effects of any reclassifications.

BC100B The Board also concluded that entities with puttable financial instruments classified as equity should be required to disclose additional information to allow users to assess any effect on the entity's liquidity arising from the ability of the holder to put the instruments to the issuer. Financial instruments classified as equity usually do not include any obligation for the entity to deliver a financial asset to another party. Therefore, the Board concluded that additional disclosures are needed in these circumstances. In particular, the Board concluded that entities should disclose the expected cash outflow on redemption or repurchase of those financial instruments that are classified as equity and information about how that amount was determined. That information allows liquidity risk associated with the put obligation and future cash flows to be evaluated.

Presentation of measures per share

BC101 The exposure draft of 2006 did not propose to change the requirements of IAS 33 *Earnings per Share* on the presentation of basic and diluted earnings per share. A majority of respondents agreed with this decision. In their opinion, earnings per share should be the only measure per share permitted or required in the statement of comprehensive income and changing those requirements was beyond the scope of this stage of the financial statement presentation project.

BC102 However, some respondents would like to see alternative measures per share whenever earnings per share is not viewed as the most relevant measure for financial analysts (ie credit rating agencies that focus on other measures). A few respondents proposed that an entity should also display an amount per share for total comprehensive income, because this was considered a useful measure. The Board did not support including alternative measures per share in the financial statements, until totals and subtotals, and principles for aggregating and disaggregating items, are addressed and discussed as part of the next stage of the financial statement presentation project.

BC103 Some respondents also interpreted the current provisions in IAS 33 as allowing de facto a display of alternative measures in the income statement. In its deliberations, the Board was clear that paragraph 73 of IAS 33 did not leave room for confusion. However, it decided that the wording in paragraph 73 could be improved to clarify that alternative measures should be shown 'only in the notes'. This will be done when IAS 33 is revisited or as part of the annual improvements process.

BC104 One respondent commented that the use of the word 'earnings' was inappropriate in the light of changes proposed in the exposure draft and that the measure should be denominated 'profit or loss per share', instead. The Board considered that this particular change in terminology was beyond the scope of IAS 1.

Transition and effective date

BC105 The Board is committed to maintaining a 'stable platform' of substantially unchanged standards for annual periods beginning between 1 January 2006 and 31 December 2008. In addition, some preparers will need time to make the system changes necessary to comply with the revisions to IAS 1. Therefore, the Board decided that the effective date of IAS 1 should be annual periods beginning on or after 1 January 2009, with earlier application permitted.

BC105A The exposure draft *Presentation of Items of Other Comprehensive Income* published in May 2010 proposed changes to presentation of items of OCI. The Board finalised these changes in June 2011 and decided that the effective dates for these changes should be for annual periods beginning on or after 1 July 2012, with earlier application permitted. The Board did not think that a long transition period was needed as the changes to presentation are small and the presentation required by the amendments is already allowed under IAS 1.

BC105B The Board had consulted on the effective date and transition requirements for this amendment in its *Request for Views on Effective Dates and Transition Requirements* in October 2010 and the responses to that document did not give the Board any reason to reconsider the effective date and the transition requirements.

Differences from SFAS 130

BC106 In developing IAS 1, the Board identified the following differences from SFAS 130:

(a) **Reporting and display of comprehensive income** Paragraph 22 of SFAS 130 permits a choice of displaying comprehensive income and its components, in one or two statements of financial performance or in a statement of changes in equity. IAS 1 (as revised in 2007) does not permit display in a statement of changes in equity.

(b) **Reporting other comprehensive income in the equity section of a statement of financial position** Paragraph 26 of SFAS 130 specifically states that the *total of other comprehensive income* is reported separately from retained earnings and additional paid-in capital in a statement of financial position at the end of the period. A descriptive title such as *accumulated other comprehensive income* is used for that component of equity. An entity discloses accumulated balances for each classification in that separate component of equity in a statement of financial position, in a statement of changes in equity, or in notes to the financial statements. IAS 1 (as revised in 2007) does not specifically require the display of a total of accumulated other comprehensive income in the statement of financial position.

(c) **Display of the share of other comprehensive income items of associates and joint ventures accounted for using the equity method** Paragraph 82 of IAS 1 (as revised in 2007) requires the display in the statement of comprehensive income of the investor's share of the investee's other comprehensive income. Paragraph 122 of SFAS 130 does not specify how that information should be displayed. An investor is permitted to combine its proportionate share of other comprehensive income amounts with its own other comprehensive income items and display the aggregate of those amounts in an income statement type format or in a statement of changes in equity.

Appendix
Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with the revised IAS 1. Amended paragraphs are shown with the new text underlined and deleted text struck through.

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The amendments contained in this appendix when this Standard was revised in 2007 have been incorporated into the relevant pronouncements.

Dissenting opinions

Dissent of Mary E Barth, Anthony T Cope, Robert P Garnett and James J Leisenring from IAS 1 (as revised in September 2007)

DO1 Professor Barth and Messrs Cope, Garnett and Leisenring voted against the issue of IAS 1 *Presentation of Financial Statements* in 2007. The reasons for their dissent are set out below.

DO2 Those Board members agree with the requirement to report all items of income and expense separately from changes in net assets that arise from transactions with owners in their capacity as owners. Making that distinction clearly is a significant improvement in financial reporting.

DO3 However, they believe that the decision to permit entities to divide the statement of comprehensive income into two separate statements is both conceptually unsound and unwise.

DO4 As noted in paragraph BC51, the *Framework*[*] does not define profit or loss, or net income. It also does not indicate what criteria should be used to distinguish between those items of recognised income and expense that should be included in profit or loss and those items that should not. In some cases, it is even possible for identical transactions to be reported inside or outside profit or loss. Indeed, in that same paragraph, the Board acknowledges these facts, and indicates that it had a preference for reporting all items of income and expense in a single statement, believing that a single statement is the conceptually correct approach. Those Board members believe that some items of income and expense that will potentially bypass the statement of profit and loss can be as significant to the assessment of an entity's performance as items that will be included. Until a conceptual distinction can be developed to determine whether any items should be reported in profit or loss or elsewhere, financial statements will lack neutrality and comparability unless all items are reported in a single statement. In such a statement, profit or loss can be shown as a subtotal, reflecting current conventions.

DO5 In the light of those considerations, it is puzzling that most respondents to the exposure draft that proposed these amendments favoured permitting a two-statement approach, reasoning that it 'distinguishes between profit and loss and total comprehensive income' (paragraph BC50). Distinguishing between those items reported in profit or loss and those reported elsewhere is accomplished by the requirement for relevant subtotals to be included in a statement of comprehensive income. Respondents also stated that a two-statement approach gives primacy to the 'income statement'; that conflicts with the Board's requirement in paragraph 11 of IAS 1 to give equal prominence to all financial statements within a set of financial statements.

DO6 Those Board members also believe that the amendments are flawed by offering entities a choice of presentation methods. The Board has expressed a desire to reduce alternatives in IFRSs. The *Preface to International Financial Reporting Standards*, in paragraph 13[†], states: 'the IASB intends not to permit choices in accounting treatment … and will continue to reconsider … those transactions and events for which IASs permit a choice of accounting treatment, with the objective of reducing the number of those choices.' The *Preface* extends this objective to both accounting and reporting. The same paragraph states: 'The IASB's objective is to require like transactions and events to be accounted for *and reported* in a like way and unlike transactions and events to be accounted for *and reported* differently' (emphasis added). By permitting a choice in this instance, the IASB has abandoned that principle.

DO7 Finally, the four Board members believe that allowing a choice of presentation at this time will ingrain practice, and make achievement of the conceptually correct presentation more difficult as the long-term project on financial statement presentation proceeds.

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

[†] Paragraph 13, slightly amended, is now paragraph 12 of the *Preface*, as amended at September 2010.

Dissent of Paul Pacter from *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1)

DO1 Mr Pacter voted against issuing the amendments to IAS 1 *Presentation of Financial Statements* set out in *Presentation of Items of Other Comprehensive Income* in June 2011. Mr Pacter believes that the Board has missed a golden opportunity to align the performance statement with the Board's *Conceptual Framework* and, thereby, improve information for users of IFRS financial statements.

DO2 Mr Pacter believes that ideally this project should have provided guidance, to the Board and to those who use IFRSs, on which items of income and expense (if any) should be presented as items of other comprehensive income (OCI) and which of those (if any) should subsequently be recycled through profit or loss. Mr Pacter acknowledges and accepts that this project has a more short-term goal – 'to improve the consistency and clarity of the presentation of items of OCI'. He believes that this project fails to deliver on that objective, for the following reasons:

(a) Consistency is not achieved because the standard allows choice between presenting performance in a single performance statement or two performance statements. Users of financial statements—and the Board itself—have often said that accounting options are not helpful for understandability and comparability of financial statements.

(b) Clarity is not achieved because allowing two performance statements is inconsistent with the *Conceptual Framework*. The *Conceptual Framework* defines two types of items that measure an entity's performance—income and expenses. Mr Pacter believes that all items of income and expense should be presented in a single performance statement with appropriate subtotals (including profit or loss, if that can be defined) and supporting disclosures. This is consistent with reporting all assets and liabilities in a single statement of financial position, rather than multiple statements. Unfortunately, neither IAS 1 nor any other IFRS addresses criteria for which items are presented in OCI. And the recent history of which items are presented in OCI suggests that the decisions are based more on expediency than conceptual merit. In Mr Pacter's judgement, that is all the more reason to have all items of income and expense reported in a single performance statement.

DO3 Mr Pacter believes that the Board should breathe new life into its former project on performance reporting as a matter of urgency.

Guidance on implementing IAS 1 *Presentation of Financial Statements*

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

Illustrative financial statement structure

IG1 IAS 1 sets out the components of financial statements and minimum requirements for disclosure in the statements of financial position, profit or loss and other comprehensive income and changes in equity. It also describes further items that may be presented either in the relevant financial statement or in the notes. This guidance provides simple examples of ways in which the requirements of IAS 1 for the presentation of the statements of financial position, profit or loss and other comprehensive income and changes in equity might be met. An entity should change the order of presentation, the titles of the statements and the descriptions used for line items when necessary to suit its particular circumstances.

IG2 The guidance is in three sections. Paragraphs IG3–IG6 provide examples of the presentation of financial statements. Paragraphs IG7–IG9 provide an example of the determination of reclassification adjustments for available-for-sale financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. Paragraphs IG10 and IG11 provide examples of capital disclosures.

IG3 The illustrative statement of financial position shows one way in which an entity may present a statement of financial position distinguishing between current and non-current items. Other formats may be equally appropriate, provided the distinction is clear.

IG4 The illustrations use the term 'comprehensive income' to label the total of all items ~~components~~ of profit or loss and other comprehensive income~~, including profit or loss~~. The illustrations use the term 'other comprehensive income' to label income and expenses that are included in comprehensive income but excluded from profit or loss. IAS 1 does not require an entity to use those terms in its financial statements.

IG5 Two statements of profit or loss and other comprehensive income are provided, to illustrate the alternative presentations of income and expenses in a single statement or in two statements. The ~~single~~ statement of profit or loss and other comprehensive income illustrates the classification of income and expenses within profit or loss by function. The separate statement (in this example, 'the ~~income~~ statement or profit or loss') illustrates the classification of income and expenses within profit by nature.

IG5A Two sets of examples of statements of profit or loss and other comprehensive income are shown. One shows the presentation while IAS 39 *Financial Instruments: Recognition and Measurement* remains effective and is applied; the other shows presentation when IFRS 9 *Financial Instruments* is applied.

IG6 The examples are not intended to illustrate all aspects of IFRSs, nor do they constitute a complete set of financial statements, which would also include a statement of cash flows, a summary of significant accounting policies and other explanatory information.

Part I: Illustrative presentation of financial statements

XYZ Group – Statement of financial position as at 31 December 20X7

(in thousands of currency units)

	31 Dec 20X7	**31 Dec 20X6**
ASSETS		
Non-current assets		
Property, plant and equipment	350,700	360,020
Goodwill	80,800	91,200
Other intangible assets	227,470	227,470
Investments in associates	100,150	110,770
Available-for-sale financial assets	142,500	156,000
	901,620	945,460
Current assets		
Inventories	135,230	132,500
Trade receivables	91,600	110,800
Other current assets	25,650	12,540
Cash and cash equivalents	312,400	322,900
	564,880	578,740
Total assets	1,466,500	1,524,200

continued...

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XYZ Group – Statement of financial position as at 31 December 20X7

(in thousands of currency units)

	31 Dec 20X7	31 Dec 20X6
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	650,000	600,000
Retained earnings	243,500	161,700
Other components of equity	10,200	21,200
	903,700	782,900
Non-controlling interests	70,050	48,600
Total equity	973,750	831,500
Non-current liabilities		
Long-term borrowings	120,000	160,000
Deferred tax	28,800	26,040
Long-term provisions	28,850	52,240
Total non-current liabilities	177,650	238,280
Current liabilities		
Trade and other payables	115,100	187,620
Short-term borrowings	150,000	200,000
Current portion of long-term borrowings	10,000	20,000
Current tax payable	35,000	42,000
Short-term provisions	5,000	4,800
Total current liabilities	315,100	454,420
Total liabilities	492,750	692,700
Total equity and liabilities	1,466,500	1,524,200

Examples of statement of profit or loss and other comprehensive income

XYZ Group – Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7

(illustrating the presentation of profit or loss and other comprehensive income in one statement and the classification of expenses within profit or loss by function)

(in thousands of currency units)

	20X7	**20X6**
Revenue	390,000	355,000
Cost of sales	(245,000)	(230,000)
Gross profit	145,000	125,000
Other income	20,667	11,300
Distribution costs	(9,000)	(8,700)
Administrative expenses	(20,000)	(21,000)
Other expenses	(2,100)	(1,200)
Finance costs	(8,000)	(7,500)
Share of profit of associates[(a)]	35,100	30,100
Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	933	3,367
Remeasurements of defined benefit pension plans	(667)	1,333
Share of gain (loss) on property revaluation of associates[(b)]	400	(700)
Income tax relating to items that will not be reclassified[(c)]	(166)	(1,000)
	500	3,000
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translating foreign operations[(d)]	5,334	10,667
Available-for-sale financial assets[(d)]	(24,000)	26,667
Cash flow hedges[(d)]	(667)	(4,000)
Income tax relating to items that may be reclassified[(c)]	4,833	(8,334)
	(14,500)	25,000
Other comprehensive income for the year, net of tax	(14,000)	28,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500

continued…

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Examples of statement of profit or loss and other comprehensive income

XYZ Group – Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7

(illustrating the presentation of profit or loss and other comprehensive income in one statement and the classification of expenses within profit or loss by function)

(in thousands of currency units)

Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	24,250	13,100
	121,250	65,500
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non-controlling interests	21,450	18,700
	107,250	93,500
Earnings per share (in currency units):		
Basic and diluted	0.46	0.30

Alternatively, items of other comprehensive income could be presented in the statement of profit or loss and other comprehensive income net of tax.

Other comprehensive income for the year, after tax:	**20X7**	**20X6**
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	600	2,700
Remeasurements of defined benefit pension plans	(500)	1,000
Share of gain (loss) on property revaluation of associates	400	(700)
	500	3,000
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translating foreign operations	4,000	8,000
Available-for-sale financial assets	(18,000)	20,000
Cash flow hedges	(500)	(3,000)
	(14,500)	25,000
Other comprehensive income for the year, net of tax[(c)]	(14,000)	28,000

(a) This means the share of associates' profit attributable to owners of the associates, ie it is after tax and non-controlling interests in the associates.

(b) This means the share of associates' gain (loss) on property revaluation attributable to owners of the associates, ie it is after tax and non-controlling interests in the associates.

(c) The income tax relating to each item of other comprehensive income is disclosed in the notes.

(d) This illustrates the aggregated presentation, with disclosure of the current year gain or loss and reclassification adjustment presented in the notes. Alternatively, a gross presentation can be used.

XYZ Group – Statement of profit or loss for the year ended 31 December 20X7

(illustrating the presentation of profit or loss and other comprehensive income in two statements and the classification of expenses within profit or loss by nature)

(in thousands of currency units)

	20X7	**20X6**
Revenue	390,000	355,000
Other income	20,667	11,300
Changes in inventories of finished goods and work in progress	(115,100)	(107,900)
Work performed by the entity and capitalised	16,000	15,000
Raw material and consumables used	(96,000)	(92,000)
Employee benefits expense	(45,000)	(43,000)
Depreciation and amortisation expense	(19,000)	(17,000)
Impairment of property, plant and equipment	(4,000)	–
Other expenses	(6,000)	(5,500)
Finance costs	(15,000)	(18,000)
Share of profit of associates[(a)]	35,100	30,100
Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500
Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	24,250	13,100
	121,250	65,500
Earnings per share (in currency units):		
Basic and diluted	0.46	0.30

(a) This means the share of associates' profit attributable to owners of the associates, ie it is after tax and non-controlling interests in the associates.

XYZ Group – Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7

(illustrating the presentation of profit or loss and other comprehensive income in two statements)

(in thousands of currency units)

	20X7	20X6
Profit for the year	121,250	65,500
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	933	3,367
Remeasurements of defined benefit pension plans	(667)	1,333
Share of gain (loss) on property revaluation of associates[a]	400	(700)
Income tax relating to items that will not be reclassified[b]	(166)	(1,000)
	500	3,000
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translating foreign operations	5,334	10,667
Available-for-sale financial assets	(24,000)	26,667
Cash flow hedges	(667)	(4,000)
Income tax relating to items that may be reclassified[b]	4,833	(8,334)
	(14,500)	25,000
Other comprehensive income for the year, net of tax	(14,000)	28,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non-controlling interests	21,450	18,700
	107,250	93,500

Alternatively, items of other comprehensive income could be presented, net of tax. Refer to the statement of profit or loss and other comprehensive income illustrating the presentation of income and expenses in one statement.

(a) This means the share of associates' gain (loss) on property revaluation attributable to owners of the associates, ie it is after tax and non-controlling interests in the associates.

(b) The income tax relating to each item of other comprehensive income is disclosed in the notes.

XYZ Group

Disclosure of components of other comprehensive income[(a)]

Notes

Year ended 31 December 20X7

(in thousands of currency units)

		20X7		20X6
Other comprehensive income:				
Exchange differences on translating foreign operations[(b)]		5,334		10,667
Available-for-sale financial assets:				
Gains arising during the year	1,333		30,667	
Less: Reclassification adjustments for gains included in profit or loss	(25,333)	(24,000)	(4,000)	26,667
Cash flow hedges:				
Gains (losses) arising during the year	(4,667)		(4,000)	
Less: Reclassification adjustments for gains (losses) included in profit or loss	3,333		–	
Less: Adjustments for amounts transferred to initial carrying amount of hedged items	667	(667)	–	(4,000)

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XYZ Group

Disclosure of components of other comprehensive income

Notes

Year ended 31 December 20X7

(in thousands of currency units)

	20X7	**20X6**
Gains on property revaluation	933	3,367
~~Actuarial gains (losses) on~~Remeasurements of defined benefit pension plans	(667)	1,333
Share of other comprehensive income of associates	400	(700)
Other comprehensive income	(18,667)	37,334
Income tax relating to components of other comprehensive income[c]	4,667	(9,334)
Other comprehensive income for the year	(14,000)	28,000

(a) When an entity chooses an aggregated presentation in the statement of comprehensive income, the amounts for reclassification adjustments and current year gain or loss are presented in the notes.

(b) There was no disposal of a foreign operation. Therefore, there is no reclassification adjustment for the years presented.

(c) The income tax relating to each component of other comprehensive income is disclosed in the notes.

XYZ Group

Disclosure of tax effects relating to each component of other comprehensive income

Notes

Year ended 31 December 20X7

(in thousands of currency units)

	20X7 Before-tax amount	20X7 Tax (expense) benefit	20X7 Net-of-tax amount	20X6 Before-tax amount	20X6 Tax (expense) benefit	20X6 Net-of-tax amount
Exchange differences on translating foreign operations	5,334	(1,334)	4,000	10,667	(2,667)	8,000
Available-for-sale financial assets	(24,000)	6,000	(18,000)	26,667	(6,667)	20,000
Cash flow hedges	(667)	167	(500)	(4,000)	1,000	(3,000)
Gains on property revaluation	933	(333)	600	3,367	(667)	2,700
~~Actuarial gains (losses) on~~ Remeasurements of defined benefit pension plans	(667)	167	(500)	1,333	(333)	1,000
Share of other comprehensive income of associates	400	–	400	(700)	–	(700)
Other comprehensive income	(18,667)	4,667	(14,000)	37,334	(9,334)	28,000

XYZ Group – Statement of changes in equity for the year ended 31 December 20X7

(in thousands of currency units)

	Share capital	Retained earnings	Translation of foreign operations	Investments in equity instruments	Cash flow hedges	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 January 20X6	600,000	118,100	(4,000)	1,600	2,000	–	717,700	29,800	747,500
Changes in accounting policy	–	400	–	–	–	–	400	100	500
Restated balance	600,000	118,500	(4,000)	1,600	2,000	–	718,100	29,900	748,000
Changes in equity for 20X6									
Dividends	–	(10,000)	–	–	–	–	(10,000)	–	(10,000)
Total comprehensive income for the year[(a)]	–	53,200	6,400	16,000	(2,400)	1,600	74,800	18,700	93,500
Balance at 31 December 20X6	600,000	161,700	2,400	17,600	(400)	1,600	782,900	48,600	831,500
Changes in equity for 20X7									
Issue of share capital	50,000	–	–	–	–	–	50,000	–	50,000
Dividends	–	(15,000)	–	–	–	–	(15,000)	–	(15,000)
Total comprehensive income for the year[(b)]	–	96,600	3,200	(14,400)	(400)	800	85,800	21,450	107,250
Transfer to retained earnings	–	200	–	–	–	(200)	–	–	–
Balance at 31 December 20X7	650,000	243,500	5,600	3,200	(800)	2,200	903,700	70,050	973,750

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(a) The amount included in retained earnings for 20X6 of 53,200 represents profit attributable to owners of the parent of 52,400 plus ~~actuarial gains on~~remeasurements of defined benefit pension plans of 800 (1,333, less tax 333, less non-controlling interests 200).

The amount included in the translation, available-for-sale and cash flow hedge reserves represent other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to available-for-sale financial assets for 20X6 of 16,000 is 26,667, less tax 6,667, less non-controlling interests 4,000.

The amount included in the revaluation surplus of 1,600 represents the share of other comprehensive income of associates of (700) plus gains on property revaluation of 2,300 (3,367, less tax 667, less non-controlling interests 400). Other comprehensive income of associates relates solely to gains or losses on property revaluation.

(b) The amount included in retained earnings for 20X7 of 96,600 represents profit attributable to owners of the parent of 97,000 plus ~~actuarial losses on~~ remeasurements of defined benefit pension plans of 400 (667, less tax 167, less non-controlling interests 100).

The amount included in the translation, available-for-sale and cash flow hedge reserves represents other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to the translation of foreign operations for 20X7 of 3,200 is 5,334, less tax 1,334, less non-controlling interests 800.

The amount included in the revaluation surplus of 800 represents the share of other comprehensive income of associates of 400 plus gains on property revaluation of 400 (933, less tax 333, less non-controlling interests 200). Other comprehensive income of associates relates solely to gains or losses on property revaluation.

Part II: Illustrative example of the determination of reclassification adjustments

IG7 The Standard requires an entity to disclose reclassification adjustments relating to each component of other comprehensive income.

IG8 This guidance provides an illustration of the calculation of reclassification adjustments for available-for-sale financial assets recognised in accordance with IAS 39.

IG9 On 31 December 20X5, XYZ Group purchased 1,000 shares (equity instruments) at 10 currency units (CU) per share, classified as available for sale. The fair value of the instruments at 31 December 20X6 was CU12; at 31 December 20X7 the fair value had increased to CU15. All of the instruments were sold on 31 December 20X7; no dividends were declared on those instruments during the time that they were held by XYZ Group. The applicable tax rate in accordance with IAS 12 *Income Taxes* is 30 per cent.

Calculation of gains

(in currency units)

	Before tax	**Income tax**	**Net of tax**
Gains recognised in other comprehensive income:			
Year ended 31 December 20X6	2,000	(600)	1,400
Year ended 31 December 20X7	3,000	(900)	2,100
Total gain	5,000	(1,500)	3,500

Amounts reported in profit or loss and other comprehensive income for the years ended 31 December 20X6 and 31 December 20X7

	20X7	20X6
Profit or loss:		
Gain on sale of instruments	5,000	
Income tax expense	(1,500)	
Net gain recognised in profit or loss	3,500	
Other comprehensive income:		
Gain arising during the year, net of tax	2,100	1,400
Reclassification adjustment, net of tax	(3,500)	–
Net gain (loss) recognised in other comprehensive income	(1,400)	1,400
	2,100	1,400

Alternatively, components of other comprehensive income may be shown gross of tax with a separate line item for tax effects:

	20X7	20X6
Profit or loss:		
Gain on sale of instruments	5,000	
Income tax expense	(1,500)	
Net gain recognised in profit or loss	3,500	
Other comprehensive income:		
Gain arising during the year	3,000	2,000
Reclassification adjustment	(5,000)	–
Income tax relating to other comprehensive income	600	(600)
Net gain (loss) recognised in other comprehensive income	(1,400)	1,400
	2,100	1,400

Part III: Illustrative examples of capital disclosures (paragraphs 134–136)

An entity that is not a regulated financial institution

IG10 The following example illustrates the application of paragraphs 134 and 135 for an entity that is not a financial institution and is not subject to an externally imposed capital requirement. In this example, the entity monitors capital using a debt-to-adjusted capital ratio. Other entities may use different methods to monitor capital. The example is also relatively simple. An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of paragraphs 134 and 135.

Facts

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

Example disclosure

The Group's objectives when managing capital are:

- to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and

- to provide an adequate return to shareholders by pricing products and services commensurately with the level of risk.

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

Consistently with others in the industry, the Group monitors capital on the basis of the debt-to-adjusted capital ratio. This ratio is calculated as net debt ÷ adjusted capital. Net debt is calculated as total debt (as shown in the statement of financial position) less cash and cash equivalents. Adjusted capital comprises all components of equity (ie share capital, share premium, non-controlling interests, retained earnings, and revaluation surplus) other than amounts accumulated in equity relating to cash flow hedges, and includes some forms of subordinated debt.

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

	31 Dec 20X4	**31 Dec 20X3**
	CU million	**CU million**
Total debt	1,000	1,100
Less: cash and cash equivalents	(90)	(150)
Net debt	910	950
Total equity	110	105
Add: subordinated debt instruments	38	38
Less: amounts accumulated in equity relating to cash flow hedges	(10)	(5)
Adjusted capital	138	138
Debt-to-adjusted capital ratio	6.6	6.9

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

An entity that has not complied with externally imposed capital requirements

IG11 The following example illustrates the application of paragraph 135(e) when an entity has not complied with externally imposed capital requirements during the period. Other disclosures would be provided to comply with the other requirements of paragraphs 134 and 135.

Facts

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

Example disclosure

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

Appendix
Amendments to guidance on other IFRSs

The following amendments to guidance on other IFRSs are necessary in order to ensure consistency with the revised IAS 1. In the amended paragraphs, new text is underlined and deleted text is struck through.

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The amendments contained in this appendix when this guidance was issued have been incorporated into the text of the relevant guidance.

Table of Concordance

This table shows how the contents of HKAS 1 and HKAS 1 (revised 2007) correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Superseded HKAS 1 paragraph	HKAS 1 (revised 2007) paragraph
1	1, 3
2	2
3	4,7
4	None
5	5
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49, 50	36, 37
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Superseded HKAS 1 paragraph	HKAS 1 (revised 2007) paragraph
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103–107	112–116
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None	IG9
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HKAS 12
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Hong Kong Accounting Standard 12

Income Taxes

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

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CONTENTS

Introduction

IN1 HKAS 12 is effective for accounting periods beginning on or after 1 January 2005. The major features of HKAS 12 are as follows.

IN2 HKAS 12 requires an entity to account for deferred tax using the balance sheet liability method, which focuses on temporary differences. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

IN3 HKAS 12 requires an entity to recognise a deferred tax liability or (subject to certain conditions) asset for all temporary differences, with certain exceptions noted below.

IN4 HKAS 12 requires that deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised. Where an entity has a history of tax losses, the entity recognises a deferred tax asset only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available.

IN5 As an exception to the general requirement set out in paragraph IN3 above, HKAS 12 prohibits the recognition of deferred tax liabilities and deferred tax assets arising from certain assets or liabilities whose carrying amount differs on initial recognition from their initial tax base.

IN6 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ~~ventures~~arrangements, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor, joint ~~or~~ venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

Where this exception has the result that no deferred tax liabilities have been recognised, HKAS 12 requires an entity to disclose the aggregate amount of the temporary differences concerned.

IN7 HKAS 12 prohibits the recognition of deferred tax liabilities arising from the initial recognition of goodwill.

IN8 HKAS 12 requires an entity to recognise a deferred tax liability in respect of asset revaluations.

IN9 The tax consequences of recovering the carrying amount of certain assets or liabilities may depend on the manner of recovery or settlement, for example:

(a) in certain countries, capital gains are not taxed at the same rate as other taxable income; and

(b) in some countries, the amount that is deducted for tax purposes on sale of an asset is greater than the amount that may be deducted as depreciation.

HKAS 12 requires that the measurement of deferred tax liabilities and deferred tax assets should be based on the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities.

IN10 HKAS 12 prohibits discounting of deferred tax assets and liabilities.

IN11 HKAS 12 requires that an entity which makes the current/non-current distinction should not classify deferred tax assets and liabilities as current assets and liabilities.[1]

[1] This requirement has been moved to paragraph 56 of HKAS 1 (Revised) *Presentation of Financial Statements*.

- The notion of temporary differences is central to understanding the requirements of this Standard. A taxable temporary difference gives rise to a deferred tax liability. A deductible temporary difference gives rise to a deferred tax asset. A taxable or deductible temporary difference arises when the carrying amount of an asset or a liability differs from its tax base. The meaning of "tax base" is of key importance to applying the requirements of this Standard. Tax base is defined in paragraph 5 of this Standard and is generally the amount that would be shown as an asset or a liability in a statement of financial position prepared for tax purposes. Unlike the practice in some other countries, it is not customary in Hong Kong for entities to prepare tax-based statements of financial position. However, the notion of a tax-based statement of financial position is relevant to this Standard and may be used as a basis for working papers developed for the purpose of implementing this Standard.

- This Standard generally requires an entity to recognise the tax consequences of transactions and other events consistently with the way that it recognises the transactions and other events themselves. Thus, for transactions and other events recognised in net profit or loss for the period, any related tax effects are also recognised in net profit or loss for the period. For transactions and other events that are recognised as direct credits to equity (direct debits to equity), any related tax effects are generally recognised as direct debits to equity (direct credits to equity).

Scope

1 This Standard shall be applied in accounting for income taxes.

2 For the purposes of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint ~~venture~~ arrangement on distributions to the reporting entity.

3 [Deleted]

4 This Standard does not deal with the methods of accounting for government grants (see HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or investment tax credits. However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

Definitions

5 The following terms are used in this Standard with the meanings specified:

Accounting profit **is profit or loss for a period before deducting tax expense.**

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

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

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

Deferred tax liabilities **are the amounts of income taxes payable in future periods in respect of taxable temporary differences.**

Deferred tax assets **are the amounts of income taxes recoverable in future periods in respect of:**

(a) deductible temporary differences;

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ~~ventures~~ arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

16 It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. This makes it probable that economic benefits will flow from the entity in the form of tax payments. Therefore, this Standard requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.

The recovery of the carrying amount of many assets gives rise to taxable and deductible amounts. For example, an item of equipment may be used to produce goods that are in turn used to generate revenue, and therefore taxable amounts, and give rise to depreciation that is a deductible amount. When the carrying amount of the asset (equipment) exceeds its tax base, the amount of taxable economic benefits (taxable amounts) will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to settle the resulting income taxes in future periods is a deferred tax liability. The example below illustrates a circumstance in which a deferred tax liability arises that is required to be recognised by this .

Example

An example of circumstances that give rise to a deferred tax liability that is required to be recognised

An asset that costs $150 has a carrying amount of $100. Cumulative depreciation for tax purposes is $90 and the tax rate is 30%.

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
At acquisition	150	150	
Accumulated Depreciation	50	90	
Net amount	100	60	40
Tax rate			30%
Deferred Tax Liability			12

The tax base of the asset is $60 (cost of $150 less cumulative tax depreciation of $90). In recovering the carrying amount of $100, the entity will derive taxable amounts of $100, but will only be able to deduct tax depreciation of $60. Consequently, the entity will pay income taxes of $12 (calculated as $40 x 30%) as a result of recovering the carrying amount of the asset. The difference between the carrying amount of $100 and the tax base of $60 is a taxable temporary difference of $40. Therefore, the entity recognises a deferred tax liability of $12 (calculated as $40 x 30%) representing the effect on income tax payable as a consequence of recovering the carrying amount of the asset.

17 Some temporary differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences. The following are examples of temporary differences of this kind which are taxable temporary differences and which therefore result in deferred tax liabilities:

(a) interest revenue is included in accounting profit on a time proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable recognised in the statement of financial position with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected;

(b) depreciation used in determining taxable profit (tax loss) may differ from that used in determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities in determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated (if tax depreciation is less rapid than accounting depreciation, a deductible temporary difference arises and results in a deferred tax asset); and

(c) development costs may be capitalised and amortised over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred. Such development costs have a tax base of nil as they have already been deducted from taxable profit. The temporary difference is the difference between the carrying amount of the development costs and their tax base of nil.

18 Temporary differences also arise when:

(a) the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with HKFRS 3 *Business Combinations*, but no equivalent adjustment is made for tax purposes (see paragraph 19);

(b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);

(c) goodwill arises in a business combination (see paragraph 21);

(d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an entity benefits from non-taxable government grants related to assets (see paragraphs 22 and 33); or

(e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint ~~ventures~~arrangements becomes different from the tax base of the investment or interest (see paragraphs 38 - 45).

Business combinations

19 With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

Deductible temporary differences

24 **A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:**

(a) is not a business combination; and

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ~~ventures~~ arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

25 It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods.

Provisions such as guarantees, product warranties or employee entitlements (including long service payments) made for accounting purposes on an estimated basis may be deducted in determining accounting profit in the reporting period in which the liability for such items arises, but deducted in determining taxable profit when paid. The example below illustrates a circumstance in which a deferred tax asset arises.

Example

An example of circumstances that give rise to a deferred tax asset

An entity recognises a liability of $100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the entity meets claims. The tax rate is 30%.

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
Accrued Warranty Costs	100	Nil	100
Tax rate			30%
Deferred Tax Asset			30

The tax base of the liability is nil (carrying amount of $100, less the deductible amount of $100 in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable amount by $100 and, consequently, reduce its future tax payments by $30 (calculated as $100 x 30%). The difference between the carrying amount of $100 and the tax base of nil is a deductible temporary difference of $100. Therefore, the entity recognises a deferred tax asset of $30 (calculated as $100 x 30%), provided that it is probable that the entity will earn sufficient taxable amounts in future periods to benefit from a reduction in tax payments.

Unused tax losses and unused tax credits

34 **A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.**

35 The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

36 An entity considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

(a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities (see paragraph 30) are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

Reassessment of unrecognised deferred tax assets

37 At the end of each reporting period, an entity reassesses unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it more probable that the entity will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraph 24 or 34. Another example is when an entity reassesses deferred tax assets at the date of a business combination or subsequently (see paragraphs 67 and 68).

Investments in subsidiaries, branches and associates and interests in joint ~~ventures~~arrangements

38 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ~~ventures~~ arrangements (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

(a) the existence of undistributed profits of subsidiaries, branches, associates and joint ~~ventures~~arrangements;

(b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and

(c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.

In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount.

39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ~~ventures~~ arrangements, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor, joint ~~or~~ venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

40 As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

41 The non-monetary assets and liabilities of an entity are measured in its functional currency (see HKAS 21 *The Effects of Changes in Foreign Exchange Rates*). If the entity's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in a different currency, changes in the exchange rate give rise to temporary differences that result in a recognised deferred tax liability or (subject to paragraph 24) asset. The resulting deferred tax is charged or credited to profit or loss (see paragraph 58).

42 An investor in an associate does not control that entity and is usually not in a position to determine its dividend policy. Therefore, in the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor recognises a deferred tax liability arising from taxable temporary differences associated with its investment in the associate. In some cases, an investor may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount. In such cases, the deferred tax liability is measured at this amount.

43 The arrangement between the parties to a joint ~~venture~~ arrangement usually deals with the ~~sharing~~distribution of the profits and identifies whether decisions on such matters require the consent of all the ~~venturers~~parties or a ~~specified majority~~ group of the ~~venturers~~parties. When the joint venturer or joint operator can control the timing of the distribution of its share of the ~~sharing of~~ profits of the joint arrangement and it is probable that its share of the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

44 An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ~~ventures~~arrangements, to the extent that, and only to the extent that, it is probable that:

(a) the temporary difference will reverse in the foreseeable future; and

(b) taxable profit will be available against which the temporary difference can be utilised.

45 In deciding whether a deferred tax asset is recognised for deductible temporary differences associated with its investments in subsidiaries, branches and associates, and its interests in joint ~~ventures~~arrangements, an entity considers the guidance set out in paragraphs 28 to 31.

Recognition of current and deferred tax

57 Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself. Paragraphs 58 to 68C implement this principle.

Items recognised in profit or loss

58 Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from:

(a) a transaction or event which is recognised, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity (see paragraphs 61A ~~to~~ – 65); or

(b) a business combination (see paragraphs 66 ~~to~~ – 68).

59 Most deferred tax liabilities and deferred tax assets arise where income or expense is included in accounting profit in one period, but is included in taxable profit (tax loss) in a different period. The resulting deferred tax is recognised in profit or loss. Examples are when:

(a) interest, royalty or dividend revenue is received in arrears and is included in accounting profit on a time apportionment basis in accordance with HKAS 18 *Revenue*, but is included in taxable profit (tax loss) on a cash basis; and

(b) costs of intangible assets have been capitalised in accordance with HKAS 38, and are being amortised in profit or loss, but were deducted for tax purposes when they were incurred.

60 The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences. This can result, for example, from:

(a) a change in tax rates or tax laws;

(b) a reassessment of the recoverability of deferred tax assets; or

(c) a change in the expected manner of recovery of an asset.

The resulting deferred tax is recognised in profit or loss, except to the extent that it relates to items previously recognised outside profit or loss (see paragraph 63).

Items recognised outside profit or loss

61 [Deleted]

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

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

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

Offset

71 **An entity shall 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.**

72 Although current tax assets and liabilities are separately recognised and measured, they are offset in the statement of financial position subject to criteria similar to those established for financial instruments in HKAS 32. An entity will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment.

73 In consolidated financial statements, a current tax asset of one entity in a group is offset against a current tax liability of another entity in the group if, and only if, the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

74 **An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:**

(a) **the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and**

(b) **the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:**

(i) **the same taxable entity; or**

(ii) **different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.**

75 To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this Standard requires an entity to set off a deferred tax asset against a deferred tax liability of the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off current tax assets against current tax liabilities.

76 In rare circumstances, an entity may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

Tax expense

Tax expense (income) related to profit or loss from ordinary activities

77 **The tax expense (income) related to profit or loss from ordinary activities shall be presented as part of profit or loss in the statement(s) of profit or loss and other comprehensive income.**

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

(f) **the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ~~ventures~~ arrangements, for which deferred tax liabilities have not been recognised (see paragraph 39);**

(g) **in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:**

(i) **the amount of the deferred tax assets and liabilities recognised in the statement of financial position for each period presented;**

(ii) **the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the statement of financial position;**

(h) **in respect of discontinued operations, the tax expense relating to:**

(i) **the gain or loss on discontinuance; and**

(ii) **the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented;**

(i) **the amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements;**

(j) **if a business combination in which the entity is the acquirer causes a change in the amount recognised for its pre-acquisition deferred tax asset (see paragraph 67), the amount of that change; and**

(k) **if the deferred tax benefits acquired in a business combination are not recognised at the acquisition date but are recognised after the acquisition date (see paragraph 68), a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.**

82 An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

(a) **the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and**

(b) **the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.**

82A In the circumstances described in paragraph 52A, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.

83 [Deleted]

84 The disclosures required by paragraph 81(c) enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. The relationship between tax expense (income) and accounting profit may be affected by such factors as revenue that is exempt from taxation, expenses that are not deductible in determining taxable profit (tax loss), the effect of tax losses and the effect of foreign tax rates.

86 The average effective tax rate is the tax expense (income) divided by the accounting profit.

87 It would often be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches and associates and interests in joint ~~ventures~~ arrangements (see paragraph 39). Therefore, this Standard requires an entity to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, entities are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.

87A Paragraph 82A requires an entity to disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. An entity discloses the important features of the income tax systems and the factors that will affect the amount of the potential income tax consequences of dividends.

87B It would sometimes not be practicable to compute the total amount of the potential income tax consequences that would result from the payment of dividends to shareholders. This may be the case, for example, where an entity has a large number of foreign subsidiaries. However, even in such circumstances, some portions of the total amount may be easily determinable. For example, in a consolidated group, a parent and some of its subsidiaries may have paid income taxes at a higher rate on undistributed profits and be aware of the amount that would be refunded on the payment of future dividends to shareholders from consolidated retained earnings. In this case, that refundable amount is disclosed. If applicable, the entity also discloses that there are additional potential income tax consequences not practicably determinable. In the parent's separate financial statements, if any, the disclosure of the potential income tax consequences relates to the parent's retained earnings.

87C An entity required to provide the disclosures in paragraph 82A may also be required to provide disclosures related to temporary differences associated with investments in subsidiaries, branches and associates or interests in joint ~~ventures~~ arrangements. In such cases, an entity considers this in determining the information to be disclosed under paragraph 82A. For example, an entity may be required to disclose the aggregate amount of temporary differences associated with investments in subsidiaries for which no deferred tax liabilities have been recognised (see paragraph 81(f)). If it is impracticable to compute the amounts of unrecognised deferred tax liabilities (see paragraph 87) there may be amounts of potential income tax consequences of dividends not practicably determinable related to these subsidiaries.

88 An entity discloses any tax-related contingent liabilities and contingent assets in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets* may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see HKAS 10 *Events after the Reporting Period*).

Effective date

89 This Standard becomes operative for financial statements covering periods beginning on or after 1 January 2005. Earlier adoption is encouraged but not required. If an entity applies this Standard for periods beginning before 1 January 2005, shall the entity shall disclose that fact and apply Hong Kong Accounting Standards Interpretation (HKAS-INT) 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* and HKAS-INT 25 *Income Taxes – Changes in the Tax Status of an Entity or its Shareholders* at the same time.

90 This Standard supersedes SSAP 12 *Income Taxes* (issued in August 2002).

91 [Not used]

92 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 23, 52, 58, 60, 62, 63, 65, 68C, 77 and 81, deleted paragraph 61 and added paragraphs 61A, 62A and 77A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

93 Paragraph 68 shall be applied prospectively from the effective date of HKFRS 3 (as revised in 2008) to the recognition of deferred tax assets acquired in business combinations.

94 Therefore, entities shall not adjust the accounting for prior business combinations if tax benefits failed to satisfy the criteria for separate recognition as of the acquisition date and are recognised after the acquisition date, unless the benefits are recognised within the measurement period and result from new information about facts and circumstances that existed at the acquisition date. Other tax benefits recognised shall be recognised in profit or loss (or, if this Standard so requires, outside profit or loss).

95 HKFRS 3 (as revised in 2008) amended paragraphs 21 and 67 and added paragraphs 32A and 81(j) and (k). An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

96 *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

97 *[This paragraph refers to amendments with an effective date after 1 January 2013, and is* therefore not included in this edition.]

98 Paragraph 52 was renumbered as 51A, paragraph 10 and the examples following paragraph 51A were amended, and paragraphs 51B and 51C and the following example and paragraphs 51D, 51E and 99 were added by *Deferred Tax: Recovery of Underlying Assets*, issued in December 2010. An entity shall apply those amendments for annual periods beginning on or after 1 January 2012. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

98A HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 2, 15, 18(e), 24, 38, 39, 43–45, 81(f), 87 and 87C. An entity shall apply those amendments when it applies HKFRS 11.

98B *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraph 77 and deleted paragraph 77A. An entity shall apply those amendments when it applies HKAS 1 as amended in July 2011.

Withdrawal of HK(SIC)- Int 21

99 The amendments made by *Deferred Tax: Recovery of Underlying Assets*, issued in December 2010, supersede Hong Kong (SIC) Interpretation 21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets.*

Acknowledgement

The Hong Kong Institute of Certified Public Accountants is indebted to the Australian Accounting Research Foundation for granting permission to use material from its Standard AASB 1020 "Income taxes" as some of the explanatory guidance and illustrative examples in this Standard.

Basis for Conclusions on IAS 12 *Income Taxes*

This Basis for Conclusions accompanies, but is not part of, IAS 12.

HKAS 12 is based on IAS 12 *Income Taxes*. In approving HKAS 12, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 12. Accordingly, there are no significant differences between HKAS 12 and IAS 12. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 12 referred to below generally correspond with those in HKAS 12.

Introduction

BC1 When IAS 12 *Income Taxes* was issued by the International Accounting Standards Committee in 1996 to replace the previous IAS 12 *Accounting for Taxes on Income* (issued in July 1979), the Standard was not accompanied by a Basis for Conclusions. This Basis for Conclusions is not comprehensive. It summarises only the International Accounting Standards Board's considerations in making the amendments to IAS 12 contained in *Deferred Tax: Recovery of Underlying Assets* issued in December 2010. Individual Board members gave greater weight to some factors than to others.

BC2 The Board amended IAS 12 to address an issue that arises when entities apply the measurement principle in IAS 12 to temporary differences relating to investment properties that are measured using the fair value model in IAS 40 *Investment Property*.

BC3 In March 2009 the Board published an exposure draft, *Income Tax* (the 2009 exposure draft), proposing a new IFRS to replace IAS 12. In the 2009 exposure draft, the Board addressed this issue as part of a broad proposal relating to the determination of tax basis. In October 2009 the Board decided not to proceed with the proposals in the 2009 exposure draft and announced that, together with the US Financial Accounting Standards Board, it aimed to conduct a fundamental review of the accounting for income tax in the future. In the meantime, the Board would address specific significant current practice issues.

BC4 In September 2010 the Board published proposals for addressing one of those practice issues in an exposure draft *Deferred Tax: Recovery of Underlying Assets* with a 60-day comment period. Although that is shorter than the Board's normal 120-day comment period, the Board concluded that this was justified because the amendments were straightforward and the exposure draft was short. In addition, the amendments were addressing a problem that existed in practice and needed to be solved as soon as possible. The Board considered the comments it received on the exposure draft and in December 2010 issued the amendments to IAS 12. The Board intends to address other practice issues arising from IAS 12 in due course, when other priorities on its agenda permit this.

Recovery of revalued non-depreciable assets

BC5 In December 2010, the Board incorporated in paragraph 51B of IAS 12 the consensus previously contained in SIC Interpretation 21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*. However, because paragraph 51C addresses investment property carried at fair value, the Board excluded such assets from the scope of paragraph 51B. Paragraphs BC6 and BC7 set out the basis that the Standing Interpretations Committee (SIC) gave for the conclusions it reached in developing the consensus expressed in SIC-21.

BC6 The SIC noted that the *Framework for the Preparation and Presentation of Financial Statements*[*] stated that an entity recognises an asset if it is probable that the future economic benefits associated with the asset will flow to the entity. Generally, those future economic benefits will be derived (and therefore the carrying amount of an asset will be recovered) through sale, through use, or through use and subsequent sale. Recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value. Consistently with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be recovered only through sale. In other words, because the asset is not depreciated, no part of its carrying amount is expected to be recovered (ie consumed) through use. Deferred taxes associated with the non-depreciable asset reflect the tax consequences of selling the asset.

[*] IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

HKAS 18

Revised ~~July 2012~~May 2014

Hong Kong Accounting Standard 18

Revenue

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

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CONTENTS

from paragraph

HONG KONG ACCOUNTING STANDARD 18

REVENUE

Hong Kong Accounting Standard 18 *Revenue* (HKAS 18) is set out in paragraphs 1-~~38~~42. All the paragraphs have equal authority. HKAS 18 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting* ~~*the Preparation and Presentation of Financial Statements*~~. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Hong Kong Accounting Standard 18
Revenue

Objective

Income is defined in the *Framework for the Preparation and Presentation of Financial Statements*[*] as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants. Income encompasses both revenue and gains. Revenue is income that arises in the course of ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends and royalties. The objective of this Standard is to prescribe the accounting treatment of revenue arising from certain types of transactions and events.

The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provides practical guidance on the application of these criteria.

Scope

1 **This Standard shall be applied in accounting for revenue arising from the following transactions and events:**

(**a**) **the sale of goods;**

(**b**) **the rendering of services; and**

(**c**) **the use by others of entity assets yielding interest, royalties and dividends.**

2 This Standard supersedes SSAP 18 *Revenue* (revised in May 2001).

3 Goods includes 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.

4 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. Revenue arising from these contracts is not dealt with in this Standard but is dealt with in accordance with the requirements for construction contracts as specified in HKAS 11 *Construction Contracts*.

5 The use by others of entity assets gives rise to revenue in the form of:

(a) interest - charges for the use of cash or cash equivalents or amounts due to the entity;

(b) royalties - charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software; and

(c) dividends - distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital.

6 This Standard does not deal with revenue arising from:

(a) lease agreements (see HKAS 17 *Leases*);

(b) dividends arising from investments which are accounted for under the equity method (see HKAS 28 *Investments in Associates and Joint Ventures*);

(c) insurance contracts within the scope of HKFRS 4 *Insurance Contracts*;

[*] In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

(d) changes in the fair value of financial assets and financial liabilities or their disposal (see HKAS 39 *Financial Instruments: Recognition and Measurement*);

(e) changes in the value of other current assets;

(f) initial recognition and from changes in the fair value of biological assets related to agricultural activity (see HKAS 41 *Agriculture*);

(g) initial recognition of agricultural produce (see HKAS 41); and

(h) the extraction of mineral ores.

Definitions

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

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.**

Fair value **~~is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction~~is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)**

8 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 which flow to the entity and 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.

Measurement of revenue

9 **Revenue shall be measured at the fair value of the consideration received or receivable.***

10 The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.

11 In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:

(a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or

(b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with HKAS 39.

* See also HK(SIC) - Int 31 *Revenue—Barter Transactions Involving Advertising Services*

12 When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. This is often the case with commodities like oil or milk where suppliers exchange or swap inventories in various locations to fulfil demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Identification of the transaction

13 The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

Sale of goods

14 Revenue from the sale of goods shall 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.

15 The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of the risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.

16 If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. An entity may retain a significant risk of ownership in a number of ways. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:

(a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;

(b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;

(c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and

(d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.

17 If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised. For example, a seller may retain the legal title to the goods solely to protect the collectibility of the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognised. Another example of an entity retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

18 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. For example, it may be uncertain that a foreign governmental authority will grant permission to remit the consideration from a sale in a foreign country. When the permission is granted, the uncertainty is removed and revenue is recognised. However, when an uncertainty arises about the collectibility of an amount already included in revenue, the uncollectible 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.

19 Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses. Expenses, including warranties and other costs to be incurred after the shipment of the goods can normally be measured reliably when the other conditions for the recognition of revenue have been satisfied. However, revenue cannot be recognised when the expenses cannot be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognised as a liability.

Rendering of services

20 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall 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.[*]

21 The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognised in the accounting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period. HKAS 11 also requires the recognition of revenue on this basis. The requirements of that Standard are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services.

[*] See also HK(SIC)-Int-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* and HK(SIC)-Int-31 *Revenue—Barter Transactions Involving Advertising Services.*

22 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility of an amount already included in revenue, the uncollectible 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.

23 An entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:

(a) each party's enforceable rights regarding the service to be provided and received by the parties;

(b) the consideration to be exchanged; and

(c) the manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of revenue as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

24 The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:

(a) surveys of work performed;

(b) services performed to date as a percentage of total services to be performed; or

(c) the proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.

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

25 For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

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

27 During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the transaction costs incurred. Therefore, revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no profit is recognised.

28 When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, revenue is not recognised and the costs incurred are recognised as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognised in accordance with paragraph 20 rather than in accordance with paragraph 26.

Interest, royalties and dividends

29 Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases set out in paragraph 30 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.

30 Revenue shall be recognised on the following bases:

(a) interest shall be recognised using the effective interest method as set out in HKAS 39, paragraphs 9 and AG5-AG8;

(b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and

(c) dividends shall be recognised when the shareholder's right to receive payment is established.

31 [Deleted]

32 When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognised as revenue.

33 Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise revenue on some other systematic and rational basis.

34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility of an amount already included in revenue, the uncollectible 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

35 An entity shall 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;

(v) dividends; and

(c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

36 An entity discloses any contingent liabilities and contingent assets in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Contingent liabilities and contingent assets may arise from items such as warranty costs, claims, penalties or possible losses.

Effective date

37 This Standard becomes operative for financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact and apply Hong Kong (SIC) Interpretation (HK(SIC)-Int) 31 *Revenue – Barter Transactions Involving Advertising Services* **at the same time.**

38 *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKAS 27 *Consolidated and Separate Financial Statements*), issued in October 2008, amended paragraph 32. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the related amendments in paragraphs 4 and 38A of HKAS 27 for an earlier period, it shall apply the amendment in paragraph 32 at the same time.

39 *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

40 *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

41 HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 6(b). An entity shall apply that amendment when it applies HKFRS 11.

42 HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 7. An entity shall apply that amendment when it applies HKFRS 13.

Illustrative example

This appendix accompanies, but is not part of, IAS 18. The examples focus on particular aspects of a transaction and are not a comprehensive discussion 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, it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

Sale of goods

The law in different countries may mean the recognition criteria in this Standard are 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.

1 '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.

2 Goods shipped subject to conditions.

(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, for example the installation of a factory tested television receiver which only requires unpacking and connection of power and antennae; or

(ii) the inspection is performed only for purposes of final determination of contract prices, for example, 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.

3 *Lay away sales under 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 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.

4 *Orders when payment (or partial payment) is received in advance of delivery for goods not presently held in inventory, for example, 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.

5 *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods.*

For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, IAS 39 *Financial Instruments: Recognition and Measurement* applies.

6 *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.

7 *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.

8 *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, using the effective interest method.

9 *Real estate sales.*

This example has been superseded by IFRIC Interpretation 15 *Agreements for the Construction of Real Estate*.

Rendering of services

10 *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.

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

When the selling price of a product includes an identifiable amount for subsequent servicing (for example, 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.

12 *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.

13 *Insurance agency commissions*.

Insurance agency commissions received or receivable which 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.

14 *Financial service fees.*

The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

(a) *Fees that are an integral part of the effective interest rate of a financial instrument.*

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognised in profit or loss, the fees are recognised as revenue when the instrument is initially recognised.

(i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IAS 39 is classified as a financial asset at 'fair value through profit or loss'.*

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs* (as defined in IAS 39), are deferred and recognised as an adjustment to the effective interest rate.

(ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IAS 39.*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in IAS 39), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

(iii) *Origination fees received on issuing financial liabilities measured at amortised cost.*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as 'at fair value through profit or loss', the origination fees received are included, with the related transaction costs (as defined in IAS 39) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) *Fees earned as services are provided.*

(i) *Fees charged for servicing a loan.*

Fees charged by an entity for servicing a loan are recognised as revenue as the services are provided.

(ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of IAS 39.*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IAS 39, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

(iii) *Investment management fees.*

Fees charged for managing investments are recognised as revenue as the services are provided.

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* In *Improvements to IFRSs* issued in May 2008, the Board replaced the term 'direct costs' with 'transaction costs' as defined in paragraph 9 of IAS 39. This amendment removed an inconsistency for costs incurred in originating financial assets and liabilities that should be deferred and recognised as an adjustment to the underlying effective interest rate. 'Direct costs', as previously defined, did not require such costs to be incremental.

Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in IAS 39, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.

(c) *Fees that are earned on the execution of a significant act.*

The fees are recognised as revenue when the significant act has been completed, as in the examples below.

(i) *Commission on the allotment of shares to a client.*

The commission is recognised as revenue when the shares have been allotted.

(ii) *Placement fees for arranging a loan between a borrower and an investor.*

The fee is recognised as revenue when the loan has been arranged.

(iii) *Loan syndication fees.*

A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.

15 *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 which reflects the extent to which services are performed at each event.

16 *Tuition fees.*

Revenue is recognised over the period of instruction.

17 *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 collectibility exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase 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.

18 *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 the 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 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 (such as 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 collectible 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 which, in substance, involve the franchisor acting as an 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.

19 *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.

Interest, royalties and dividends

20 *Licence fees and royalties.*

Fees and royalties paid for the use of an entity's assets (such as 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 which permits the licensee to exploit those rights freely and 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.

Recognition and measurement

21 *Determining whether an entity is acting as a principal or as an agent (2009 amendment).*

Paragraph 8 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.

Appendix A

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at October 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 18.

The International Accounting Standard comparable with HKAS 18 is IAS 18 *Revenue*.

There are no major textual differences between HKAS 18 and IAS 18.

HKAS 21

Revised ~~July 2012~~May 2014

Hong Kong Accounting Standard 21

The Effects of Changes in Foreign Exchange Rates

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

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CONTENTS

Hong Kong Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (HKAS 21) is set out in paragraphs 1-62 and Appendix B. All the paragraphs have equal authority. HKAS 21 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (HKAS 21) should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged.

Reasons for issuing HKAS 21

IN2 The objectives of the HKICPA in issuing HKAS 21 were to reduce or eliminate alternatives, redundancies and conflicts within the HKFRSs, to deal with some convergence issues and to make other improvements.

IN3 For HKAS 21 the HKICPA's main objective was to provide additional guidance on the translation method and on determining the functional and presentation currencies. The HKICPA did not reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates contained in HKAS 21.

The main features

IN4 The main features of HKAS 21 are described below.

Scope

IN5 The Standard excludes from its scope foreign currency derivatives that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement.*

Definitions

IN6 Two notions are used:

- functional currency, ie the currency of the primary economic environment in which the entity operates.
- presentation currency, ie the currency in which financial statements are presented.

Definitions—functional currency

IN7 When a reporting entity prepares financial statements, the Standard requires each individual entity included in the reporting entity—whether it is a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—to determine its functional currency and measure its results and financial position in that currency.

IN8 [Not used]

IN9 [Not used]

Reporting foreign currency transactions in the functional currency—recognition of exchange differences

IN10 [Not used]

Reporting foreign currency transactions in the functional currency—change in functional currency

IN11 A change in functional currency is accounted for prospectively.

Use of a presentation currency other than the functional currency—translation to the presentation currency

IN12 The Standard permits an entity to present its financial statements in any currency (or currencies). For this purpose, an entity could be a stand-alone entity, a parent preparing consolidated financial statements in accordance with HKFRS10 *Consolidated Financial Statements* or a parent, an investor with joint control of, or significant influence over, an investee ~~or a venture~~ preparing separate financial statements in accordance with HKAS 27 *~~Consolidated and~~ Separate Financial Statements*.

IN13 An entity is required to translate its results and financial position from its functional currency into a presentation currency (or currencies) using the method required for translating a foreign operation for inclusion in the reporting entity's financial statements. Under this method, assets and liabilities are translated at the closing rate, and income and expenses are translated at the exchange rates at the dates of the transactions (or at the average rate for the period when this is a reasonable approximation).

IN14 The Standard requires comparative amounts to be translated as follows:

(a) for an entity whose functional currency is not the currency of a hyperinflationary economy:

  (i) assets and liabilities in each statement of financial position presented are translated at the closing rate at the date of that statement of financial position (ie last year's comparatives are translated at last year's closing rate).

  (ii) income and expenses in each statement presenting profit or loss and other~~of~~ comprehensive income ~~or separate income statement presented~~ are translated at exchange rates at the dates of the transactions (ie last year's comparatives are translated at last year's actual or average rate).

(b) for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are translated into the currency of a different hyperinflationary economy, all amounts (eg amounts in a statement of financial position and statement of comprehensive income) are translated at the closing rate of the most recent statement of financial position presented (ie last year's comparatives, as adjusted for subsequent changes in the price level, are translated at this year's closing rate).

(c) for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are translated into the currency of a non-hyperinflationary economy, all amounts are those presented in the prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

This translation method, like that described in paragraph IN13, applies when translating the financial statements of a foreign operation for inclusion in the financial statements of the reporting entity, and when translating the financial statements of an entity into a different presentation currency.

Use of a presentation currency other than the functional currency—translation of a foreign operation

IN15 The Standard requires goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate.

Disclosure

IN16 [Not used]

IN17 Entities must disclose when there has been a change in functional currency, and the reasons for the change.

Hong Kong Accounting Standard 21
The Effects of Changes in Foreign Exchange Rates

Objective

1 An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

2 The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

3 This Standard shall be applied:

(a) in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*;

(b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation~~,~~ ~~proportionate consolidation~~ or the equity method; and

(c) in translating an entity's results and financial position into a presentation currency.

4 HKAS 39 applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of HKAS 39 (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.

5 This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. HKAS 39 applies to hedge accounting.

6 This Standard applies to the presentation of an entity's financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with Hong Kong Financial Reporting Standards (HKFRSs). For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.

7 This Standard does not apply to the presentation in a statement of cash flows of the cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see HKAS 7 *Statement of Cash Flows*).

Definitions

8 The following terms are used in this Standard with the meanings specified:

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

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

Exchange rate **is the ratio of exchange for two currencies.**

Fair value ~~**is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**~~ **is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)**

Foreign currency **is a currency other than the functional currency of the entity.**

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

Functional currency **is the currency of the primary economic environment in which the entity operates.**

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

Monetary items **are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.**

Net investment in a foreign operation **is the amount of the reporting entity's interest in the net assets of that operation.**

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

Spot exchange rate **is the exchange rate for immediate delivery.**

Elaboration on the definitions

Functional currency

9 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:

(a) the currency:

(i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and

(ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

10 The following factors may also provide evidence of an entity's functional currency:

(a) the currency in which funds from financing activities (ie issuing debt and equity instruments) are generated.

(b) the currency in which receipts from operating activities are usually retained.

11 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint ~~venture~~arrangement):

(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.

12 When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 9 before considering the indicators in paragraphs 10 and 11, which are designed to provide additional supporting evidence to determine an entity's functional currency.

13 An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

14 If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with HKAS 29 *Financial Reporting in Hyperinflationary Economies*. An entity cannot avoid restatement in accordance with HKAS 29 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent).

Net investment in a foreign operation

15 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 32 and 33. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

15A The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 15 may be any subsidiary of the group. For example, an entity has two subsidiaries, A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B would be part of the entity's net investment in Subsidiary B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. This would also be true if Subsidiary A were itself a foreign operation.

Monetary items

16 The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognised as a liability. Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (eg prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

Summary of the approach required by this Standard

17 In preparing financial statements, each entity—whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—determines its functional currency in accordance with paragraphs 9-14. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 20-37 and 50.

18 Many reporting entities comprise a number of individual entities (eg a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint ~~ventures~~arrangements. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 38-50.

19 This Standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with HKAS 27 *~~Consolidated and~~ Separate Financial Statements* to present its financial statements in any currency (or currencies). If the entity's presentation currency differs from its functional currency, its results and financial position are also translated into the presentation currency in accordance with paragraphs 38-50.

Reporting foreign currency transactions in the functional currency

Initial recognition

20 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

21 A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

22 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with HKFRSs. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at the ends of subsequent reporting periods

23 At the end of each reporting period:

(a) foreign currency monetary items shall be translated using the closing rate;

(b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and

(c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was ~~determined~~measured.

24 The carrying amount of an item is determined in conjunction with other relevant Standards. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with HKAS 16 *Property, Plant and Equipment*. Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.

25 The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is the lower of cost and net realisable value in accordance with HKAS 2 *Inventories.* Similarly, in accordance with HKAS 36 *Impairment of Assets,* the carrying amount of an asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:

(a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (ie the rate at the date of the transaction for an item measured in terms of historical cost), and

(b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (eg the closing rate at the end of the reporting period).

The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa.

26 When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

Recognition of exchange differences

27 As noted in paragraph 3(a) and 5, HKAS 39 applies to hedge accounting for foreign currency items. The application of hedge accounting requires an entity to account for some exchange differences differently from the treatment of exchange differences required by this Standard. For example, HKAS 39 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge are recognised initially in other comprehensive income to the extent that the hedge is effective.

28 Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise, except as described in paragraph 32.

29 When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates during each period.

30 When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss shall be recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.

31 Other HKFRSs require some gains and losses to be recognised in other comprehensive income. For example, HKAS 16 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised in other comprehensive income. When such an asset is measured in a foreign currency, paragraph 23(c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognised in other comprehensive income.

32 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 15) shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment in accordance with paragraph 48.

33 When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 28. If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 28. If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements in accordance with paragraph 28. Such exchange differences are recognised in other comprehensive income in the financial statements that include the foreign operation and the reporting entity (ie financial statements in which the foreign operation is consolidated~~, proportionately consolidated~~ or accounted for using the equity method).

34 When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 20-26. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and non-monetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in functional currency

35 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

36 As noted in paragraph 13, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

37 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income in accordance with paragraphs 32 and 39(c) are not reclassified from equity to profit or loss until the disposal of the operation.

Use of a presentation currency other than the functional currency

Translation to the presentation currency

38 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

39 The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

(a) assets and liabilities for each statement of financial position presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;

(b) income and expenses for each statement ~~of~~presenting profit or loss and other comprehensive income~~ or separate income statement presented~~ (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be recognised in other comprehensive income.

40 For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

41 The exchange differences referred to in paragraph 39(c) result from:

(a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate.

(b) translating the opening net assets at a closing rate that differs from the previous closing rate.

These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. The cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation. When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to non-controlling interests are allocated to, and recognised as part of, non-controlling interests in the consolidated statement of financial position.

42 The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

(a) all amounts (ie assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, except that

(b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

43 When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with HKAS 29 before applying the translation method set out in paragraph 42, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 42(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with HKAS 29, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.

Translation of a foreign operation

44 Paragraphs 45-47, in addition to paragraphs 38-43, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation~~, proportionate consolidation~~ or the equity method.

45 The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see HKFRS 10 *Consolidated Financial Statements*~~HKAS 27 and HKAS 31 *Interests in Joint Ventures*~~). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference is recognised in profit or loss or, if it arises from the circumstances described in paragraph 32, it is recognised in other comprehensive income and accumulated in a separate component of equity until the disposal of the foreign operation.

46 When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done, ~~HKAS 27~~HKFRS 10 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. Adjustments are made for significant changes in exchange rates up to the end of the reporting period of the reporting entity in accordance with ~~HKAS 27~~HKFRS 10. The same approach is used in applying the equity method to associates and joint ventures ~~and in applying proportionate consolidation to joint ventures~~ in accordance with HKAS 28 (as amended in 2011) ~~*Investments in Associates* and HKAS 31~~.

47 Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

Disposal or partial disposal of a foreign operation

48 On the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, recognised in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised (see HKAS 1 *Presentation of Financial Statements* (as revised in 2007)).

48A In addition to the disposal of an entity's entire interest in a foreign operation, the following partial disposals are accounted for as disposals ~~even if the entity retains an interest in the former subsidiary, associate or jointly controlled entity~~:

(a) when the partial disposal involves the loss of control of a subsidiary that includes a foreign operation, regardless of whether the entity retains a non-controlling interest in its former subsidiary after the partial disposal; and

(b) when the retained interest after the partial disposal of an interest in ~~the loss of significant influence over an~~ a joint arrangement or a partial disposal of an interest in an associate that includes a foreign operation is a financial asset that includes a foreign operation.~~; and~~

~~(c) the loss of joint control over a jointly controlled entity that includes a foreign operation.~~

48B On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss.

48C On the partial disposal of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

48D A partial disposal of an entity's interest in a foreign operation is any reduction in an entity's ownership interest in a foreign operation, except those reductions in paragraph 48A that are accounted for as disposals.

49 An entity may dispose or partially dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

Tax effects of all exchange differences

50 Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have tax effects. HKAS 12 *Income Taxes* applies to these tax effects.

Disclosure

51 In paragraphs 53 and 55-57 references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.

52 An entity shall disclose:

(a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with HKAS 39; and

(b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

53 When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.

54 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.

55 When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with HKFRSs only if they comply with all the requirements of HKFRSs including the translation method set out in paragraphs 39 and 42.

56 An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 55. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with HKFRSs and the disclosures set out in paragraph 57 are required.

57 When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 55 are not met, it shall:

(a) clearly identify the information as supplementary information to distinguish it from the information that complies with HKFRSs;

(b) disclose the currency in which the supplementary information is displayed; and

(c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Effective date and transition

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

58A *Net Investment in a Foreign Operation* (Amendment to HKAS 21), issued in January 2006, added paragraph 15A and amended paragraph 33. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.

59 An entity shall apply paragraph 47 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this Standard is first applied. Retrospective application of paragraph 47 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.

60 All other changes resulting from the application of this Standard shall be accounted for in accordance with the requirements of HKAS 8 Acc*ounting Policies, Changes in Accounting Estimates and Errors*.

60a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

60A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 27, 30–33, 37, 39, 41, 45, 48 and 52. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

60B HKAS 27 (as amended in 2008) added paragraphs 48A–48D and amended paragraph 49. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.

60C *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

60D Paragraph 60B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

60E *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

60F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 3(b), 8, 11, 18, 19, 33, 44-46 and 48A. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

60G HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 8 and amended paragraph 23. An entity shall apply those amendments when it applies HKFRS 13.

60H *Presentation of items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraph 39. An entity shall apply that amendment when it applies HKAS 1 as amended in July 2011.

Withdrawal of other pronouncements

61 This Standard supersedes SSAP 11 *Foreign Currency Translation* (revised in 2001).

62 [Not used]

Appendix A

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at 9 March 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 21.

The International Accounting Standard comparable with HKAS 21 is IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

There are no major textual differences between HKAS 21 and IAS 21.

Appendix B

Amendments to Other Pronouncements

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

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

Basis for Conclusions on
IAS 21 *The Effects of Changes in Foreign Exchange Rates*

This Basis for Conclusions accompanies, but is not part of, IAS 21.

Paragraph BC1 was amended and paragraphs BC25A–BC25F were added in relation to the amendment to IAS 21 issued in December 2005.

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

HKAS 21 is based on IAS 21 *The Effects of Changes in Foreign Exchange Rates*. In approving HKAS 21, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 21 (as revised 2003). Accordingly, there are no significant differences between HKAS 21 and IAS 21. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 21 referred to below generally correspond with those in HKAS 21.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 21 *The Effects of Changes in Foreign Exchange Rates* in 2003, and on the amendment to IAS 21 *Net Investment in a Foreign Operation* in December 2005. Individual Board members gave greater weight to some factors than to others.

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 21. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an Exposure Draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the Exposure Draft.

BC3 Because the Board's intention was not to reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates established by IAS 21, this Basis for Conclusions does not discuss requirements in IAS 21 that the Board has not reconsidered.

Functional currency

BC4 The term 'reporting currency' was previously defined as 'the currency used in presenting the financial statements'. This definition comprises two separate notions (which were identified in SIC-19 *Reporting Currency–Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*):

- the measurement currency (the currency in which the entity measures the items in the financial statements); and
- the presentation currency (the currency in which the entity presents its financial statements).

The Board decided to revise the previous version of IAS 21 to incorporate the SIC-19 approach of separating these two notions. The Board also noted that the term 'functional currency' is more commonly used than 'measurement currency' and decided to adopt the more common term.

BC5 The Board noted a concern that the guidance in SIC-19 on determining a measurement currency could permit entities to choose one of several currencies, or to select an inappropriate currency. In particular, some believed that SIC-19 placed too much emphasis on the currency in which transactions are denominated and too little emphasis on the underlying economy that determines the pricing of those transactions. To meet these concerns, the Board defined functional currency as 'the currency of the primary economic environment in which the entity operates'. The Board also provided guidance on how to determine the functional currency (see paragraphs 9-14 of the Standard). This guidance draws heavily on SIC-19 and equivalent guidance in US and other national standards, but also reflects the Board's decision that some factors merit greater emphasis than others.

BC6 The Board also discussed whether a foreign operation that is integral to the reporting entity (as described in the previous version of IAS 21) could have a functional currency that is different from that of its 'parent'.[*] The Board decided that the functional currencies will always be the same, because it would be contradictory for an integral foreign operation that 'carries on business as if it were an extension of the reporting enterprise's operations'[9] to operate in a primary economic environment different from its parent.

BC7 It follows that it is not necessary to translate the results and financial position of an integral foreign operation when incorporating them into the financial statements of the parent—they will already be measured in the parent's functional currency. Furthermore, it is not necessary to distinguish between an integral foreign operation and a foreign entity. When a foreign operation's functional currency is different from that of its parent, it is a foreign entity, and the translation method in paragraphs 38-49 of the Standard applies.

BC8 The Board also decided that the principles in the previous version of IAS 21 for distinguishing an integral foreign operation from a foreign entity are relevant in determining an operation's functional currency. Hence it incorporated these principles into the Standard in that context.

BC9 The Board agreed that the indicators in paragraph 9 are the primary indicators for determining the functional currency and that paragraphs 10 and 11 are secondary. This is because the indicators in paragraphs 10 and 11 are not linked to the primary economic environment in which the entity operates but provide additional supporting evidence to determine an entity's functional currency.

Presentation currency

BC10 A further issue is whether an entity should be permitted to present its financial statements in a currency (or currencies) other than its functional currency. Some believe it should not. They believe that the functional currency, being the currency of the primary economic environment in which the entity operates, most usefully portrays the economic effect of transactions and events on the entity. For a group that comprises operations with a number of functional currencies, they believe that the consolidated financial statements should be presented in the functional currency that management uses when controlling and monitoring the performance and financial position of the group. They also believe that allowing an entity to present its financial statements in more than one currency may confuse, rather than help, users of those financial statements. Supporters of this view believe that any presentation in a currency other than that described above should be regarded as a 'convenience translation' that is outside the scope of IFRSs.

BC11 Others believe that the choice of presentation currency should be limited, for example, to the functional currency of one of the substantive entities within a group. However, such a restriction might be easily overcome—an entity that wished to present its financial statements in a different currency might establish a substantive, but relatively small operation with that functional currency.

BC12 Still others believe that, given the rising trend towards globalisation, entities should be permitted to present their financial statements in any currency. They note that most large groups do not have a single functional currency, but rather comprise operations with a number of functional currencies. For such entities, they believe it is not clear which currency should be the presentation currency, or why one currency is preferable to another. They also point out that management may not use a single currency when controlling and monitoring the performance and financial position of such a group. In addition, they note that in some jurisdictions, entities are required to present their financial statements in the local currency, even when this is not the functional currency.[#] Hence, if IFRSs required the financial statements to be presented in the functional currency, some entities would have to present two sets of financial statements: financial statements that comply with IFRSs presented in the functional currency and financial statements that comply with local regulations presented in a different currency.

[*] The term 'parent' is used broadly in this context to mean an entity that has a branch, associate or joint venture, as well as one with a subsidiary.

[9] IAS 21 (revised 1993), paragraph 24

[#] This includes entities operating in another country and, for example, publishing financial statements to comply with a listing requirement of that country.

BC13 The Board was persuaded by the arguments in the previous paragraph. Accordingly, it decided that entities should be permitted to present their financial statements in any currency (or currencies).

BC14 The Board also clarified that the Standard does not prohibit the entity from providing, as supplementary information, a 'convenience translation'. Such a 'convenience translation' may display financial statements (or selected portions of financial statements) in a currency other than the presentation currency, as a convenience to some users. The 'convenience translation' may be prepared using a translation method other than that required by the Standard. These types of 'convenience translations' should be clearly identified as supplementary information to distinguish them from information required by IFRSs and translated in accordance with the Standard.

Translation method

BC15 The Board debated which method should be used to translate financial statements from an entity's functional currency into a different presentation currency.

BC16 The Board agreed that the translation method should not have the effect of substituting another currency for the functional currency. Put another way, presenting the financial statements in a different currency should not change the way in which the underlying items are measured. Rather, the translation method should merely express the underlying amounts, as measured in the functional currency, in a different currency.

BC17 Given this, the Board considered two possible translation methods. The first is to translate all amounts (including comparatives) at the most recent closing rate. This method has several advantages: it is simple to apply; it does not generate any new gains and losses; and it does not change ratios such as return on assets. This method is supported by those who believe that the process of merely expressing amounts in a different currency should preserve the relationships among amounts as measured in the functional currency and, as such, should not lead to any new gains or losses.

BC18 The second method considered by the Board is the one that the previous version of IAS 21 required for translating the financial statements of a foreign operation.* This method results in the same amounts in the presentation currency regardless of whether the financial statements of a foreign operation are:

(a) first translated into the functional currency of another group entity (eg the parent) and then into the presentation currency, or

(b) translated directly into the presentation currency.

BC19 This method avoids the need to decide the currency in which to express the financial statements of a multinational group before they are translated into the presentation currency. As noted above, many large groups do not have a single functional currency, but comprise operations with a number of functional currencies. For such entities it is not clear which functional currency should be chosen in which to express amounts before they are translated into the presentation currency, or why one currency is preferable to another. In addition, this method produces the same amounts in the presentation currency for a stand-alone entity as for an identical subsidiary of a parent whose functional currency is the presentation currency.

BC20 The Board decided to require the second method, ie that the financial statements of any entity (whether a stand-alone entity, a parent or an operation within a group) whose functional currency differs from the presentation currency used by the reporting entity are translated using the method set out in paragraphs 38-49 of the Standard.

* This is to translate balance sheet items at the closing rate and income and expense items at actual (or average) rates, except for an entity whose functional currency is that of a hyperinflationary economy.

BC21 With respect to translation of comparative amounts, the Board adopted the approach required by SIC-30 for:

(a) an entity whose functional currency is not the currency of the hyperinflationary economy (assets and liabilities in the comparative balance sheet are translated at the closing rate at the date of that balance sheet and income and expenses in the comparative income statement are translated at exchange rates at the dates of the transactions); and

(b) an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into the currency of a hyperinflationary economy (both balance sheet and income statement items are translated at the closing rate of the most recent balance sheet presented).

BC22 However, the Board decided not to adopt the SIC-30 approach for the translation of comparatives for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into a presentation currency of a non-hyperinflationary economy. The Board noted that in such a case, the SIC-30 approach requires restating the comparative amounts from those shown in last year's financial statements for both the effects of inflation and for changes in exchange rates. If exchange rates fully reflect differing price levels between the two economies to which they relate, the SIC-30 approach will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. Furthermore, the Board noted that in the prior year, the relevant amounts had been already expressed in the non-hyperinflationary presentation currency, and there was no reason to change them. For these reasons the Board decided to require that all comparative amounts are those presented in the prior year financial statements (ie there is no adjustment for either subsequent changes in the price level or subsequent changes in exchange rates).

BC23 The Board decided to incorporate into the Standard most of the disclosure requirements of SIC-30 *Reporting Currency–Translation from Measurement Currency to Presentation Currency* that apply when a different translation method is used or other supplementary information, such as an extract from the full financial statements, is displayed in a currency other than the functional currency (see paragraph 57 of the Standard). These disclosures enable users to distinguish information prepared in accordance with IFRSs from information that may be useful to users but is not the subject of IFRSs, and also tell users how the latter information has been prepared.

Capitalisation of exchange differences

BC24 The previous version of IAS 21 allowed a limited choice of accounting for exchange differences that arise 'from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset'[*]. The benchmark treatment was to recognise such exchange differences in profit or loss. The allowed alternative was to recognise them as an asset.

BC25 The Board noted that the allowed alternative (of recognition as an asset) was not in accordance with the *Framework for the Preparation and Presentation of Financial Statements*[#] because exchange losses do not meet the definition of an asset. Moreover, recognition of exchange losses as an asset is neither allowed nor required by any liaison standard-setter, so its deletion would improve convergence. Finally, in many cases when the conditions for recognition as an asset are met, the asset would be restated in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies*. Thus, to the extent that an exchange loss reflects hyperinflation, this effect is taken into account by IAS 29. For all of these reasons, the Board removed the allowed alternative treatment and the related SIC Interpretation is superseded.

[*] IAS 21 (revised 1993), paragraph 21

[#] In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

Net investment in a foreign operation

BC25A The principle in paragraph 32 is that exchange differences arising on a monetary item that is, in substance, part of the reporting entity's net investment in a foreign operation are initially recognised in a separate component of equity* in the consolidated financial statements of the reporting entity. Among the revisions to IAS 21 made in 2003 was the provision of guidance on this principle that required the monetary item to be denominated in the functional currency of either the reporting entity or the foreign operation. The previous version of IAS 21 did not include such guidance.

BC25B The requirements can be illustrated by the following example. Parent P owns 100 per cent of Subsidiary S. Parent P has a functional currency of UK sterling. Subsidiary S has a functional currency of Mexican pesos. Parent P grants a loan of 100 US dollars to Subsidiary S, for which settlement is neither planned nor likely to occur in the foreseeable future. IAS 21 (as revised in 2003) requires the exchange differences arising on the loan to be recognised in profit or loss in the consolidated financial statements of Parent P, whereas those differences would be recognised initially in equity in the consolidated financial statements of Parent P, if the loan were to be denominated in sterling or Mexican pesos.

BC25C After the revised IAS 21 was issued in 2003, constituents raised the following concerns:

(a) It is common practice for a monetary item that forms part of an entity's investment in a foreign operation to be denominated in a currency that is not the functional currency of either the reporting entity or the foreign operation. An example is a monetary item denominated in a currency that is more readily convertible than the local domestic currency of the foreign operation.

(b) An investment in a foreign operation denominated in a currency that is not the functional currency of the reporting entity or the foreign operation does not expose the group to a greater foreign currency exchange difference than arises when the investment is denominated in the functional currency of the reporting entity or the foreign operation. It simply results in exchange differences arising in the foreign operation's individual financial statements and the reporting entity's separate financial statements.

(c) It is not clear whether the term 'reporting entity' in paragraph 32 should be interpreted as the single entity or the group comprising a parent and all its subsidiaries. As a result, constituents questioned whether the monetary item must be transacted between the foreign operation and the reporting entity, or whether it could be transacted between the foreign operation and any member of the consolidated group, ie the reporting entity or any of its subsidiaries.

BC25D The Board noted that the nature of the monetary item referred to in paragraph 15 is similar to an equity investment in a foreign operation, ie settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Therefore, the principle in paragraph 32 to recognise exchange differences arising on a monetary item initially in a separate component of equity effectively results in the monetary item being accounted for in the same way as an equity investment in the foreign operation when consolidated financial statements are prepared. The Board concluded that the accounting treatment in the consolidated financial statements should not be dependent on the currency in which the monetary item is denominated, nor on which entity within the group conducts the transaction with the foreign operation.

BC25E Accordingly, in 2005 the Board decided to amend IAS 21. The amendment requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity* in the consolidated financial statements. This requirement applies irrespective of the currency of the monetary item and of whether the monetary item results from a transaction with the reporting entity or any of its subsidiaries.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such difference are recognised in other comprehensive income.

BC25F The Board also proposed amending IAS 21 to clarify that an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that foreign operation. Respondents to the exposure draft disagreed with this proposal. Many respondents said that the proposed amendment added a detailed rule that was not required because the principle in paragraph 15 was clear. In redeliberations, the Board agreed with those comments and decided not to proceed with that proposed amendment.

Goodwill and fair value adjustments

BC26 The previous version of IAS 21 allowed a choice of translating goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity at (a) the closing rate or (b) the historical transaction rate.

BC27 The Board agreed that, conceptually, the correct treatment depends on whether goodwill and fair value adjustments are part of:

(a) the assets and liabilities of the acquired entity (which would imply translating them at the closing rate); or

(b) the assets and liabilities of the parent (which would imply translating them at the historical rate).

BC28 The Board agreed that fair value adjustments clearly relate to the identifiable assets and liabilities of the acquired entity and should therefore be translated at the closing rate.

BC29 Goodwill is more complex, partly because it is measured as a residual. In addition, the Board noted that difficult issues can arise when the acquired entity comprises businesses that have different functional currencies (eg if the acquired entity is a multinational group). The Board discussed how to assess any resulting goodwill for impairment and, in particular, whether the goodwill would need to be 'pushed down' to the level of each different functional currency or could be accounted for and assessed at a higher level.

BC30 One view is that when the parent acquires a multinational operation comprising businesses with many different functional currencies, any goodwill may be treated as an asset of the parent/acquirer and tested for impairment at a consolidated level. Those who support this view believe that, in economic terms, the goodwill is an asset of the parent because it is part of the acquisition price paid by the parent. Thus, they believe, it would be incorrect to allocate the goodwill to the many acquired businesses and translate it into their various functional currencies. Rather, the goodwill, being treated as an asset of the parent, is not exposed to foreign currency risks, and translation differences associated with it should not be recognised. In addition, they believe that such goodwill should be tested for impairment at a consolidated level. Under this view, allocating or 'pushing down' the goodwill to a lower level, such as each different functional currency within the acquired foreign operation, would not serve any purpose.

BC31 Others take a different view. They believe that the goodwill is part of the parent's net investment in the acquired entity. In their view, goodwill should be treated no differently from other assets of the acquired entity, in particular intangible assets, because a significant part of the goodwill is likely to comprise intangible assets that do not qualify for separate recognition. They also note that goodwill arises only because of the investment in the foreign entity and has no existence apart from that entity. Lastly, they point out that when the acquired entity comprises a number of businesses with different functional currencies, the cash flows that support the continued recognition of goodwill are generated in those different functional currencies.

BC32 The Board was persuaded by the reasons set out in the preceding paragraph and decided that goodwill is treated as an asset of the foreign operation and translated at the closing rate. Consequently, goodwill should be allocated to the level of each functional currency of the acquired foreign operation. This means that the level to which goodwill is allocated for foreign currency translation purposes may be different from the level at which the goodwill is tested for impairment. Entities follow the requirements in IAS 36 *Impairment of Assets* to determine the level at which goodwill is tested for impairment.

Disposal or partial disposal of a foreign operation[*]

BC33 In the second phase of the business combinations project the Board decided that the loss of control, significant influence or joint control of an entity is accounted for as a disposal for the purposes of IAS 21. Accordingly, a former parent accounts for the loss of control over a subsidiary as a disposal of the subsidiary, even if the former subsidiary becomes an associate or jointly controlled entity[#] of the former parent. Similarly an investor accounts for the loss of significant influence over an associate or the loss of joint control over a jointly controlled entity as a disposal. The Board decided that the change in the nature of the investment is a significant economic event.

BC34 The Board also decided in the second phase of the business combinations project that:

(a) changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners);

(b) if a parent loses control of a subsidiary, the parent reclassifies from equity to profit or loss (as a reclassification adjustment) the parent's share of the exchange differences recognised in other comprehensive income relating to a foreign operation in that subsidiary; and

(c) if an investor loses significant influence over an associate or loses joint control over a jointly controlled entity, the investor reclassifies from equity to profit or loss (as a reclassification adjustment) the exchange differences recognised in other comprehensive income relating to a foreign operation in that associate or jointly controlled entity.

The amendments in paragraphs 48A–49 of the Standard reflect those decisions for the disposal or partial disposal of a foreign operation.

BC35 As part of *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements*), issued in May 2008, the Board amended IAS 27 to remove the definition of the 'cost method'. The cost method required an entity to recognise distributions as income only if they came from post-acquisition retained earnings. Distributions received in excess of such profits were regarded as a recovery of the investment and were recognised as a reduction of its cost. Consequently, the Board amended paragraph 49 to remove the reference to pre-acquisition profits and to clarify that a dividend accounted for in accordance with paragraph 38A of IAS 27 cannot be a disposal or partial disposal of a net investment in IAS 21[†].

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[*] This heading and paragraphs BC33 and BC34 were added as a consequence of amendments to IAS 27 *Consolidated and Separate Financial Statements* made as part of the second phase of the business combinations project in 2008. The consolidation requirements in IAS 27 were superseded by IRFS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements did not change.

[#] 'Jointly controlled entities' were defined in IAS 31 *Interests in Joint Ventures*. IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31 and changed the terminology.

[†] The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements for dividends were not changed.

Disposal or partial disposal of a foreign operation (amendment 2011)

BC36 During its redeliberation of the exposure draft ED 9 *Joint Arrangements*, the Board reconsidered whether its decision in the second phase of the business combinations project to characterise loss of joint control or loss of significant influence as a significant economic event (ie in the same way that loss of control is characterised as a significant economic event) was appropriate. If it were, the Board thought that the entity should be required to recalibrate the accounting as required by IFRS 10 *Consolidated Financial Statements*. However, the Board concluded that, although significant, the events are fundamentally different. In the case of loss of control, the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost the composition of the group is unaffected.

BC37 The Board also noted that retaining the characterisation of significant economic event in the case of loss of joint control or significant influence when the retained interest is a financial asset is unnecessary. IFRS 9 already requires that in such cases the retained interest (ie a financial asset) must be measured at fair value.

BC38 In the case of loss of joint control when significant influence is maintained, the Board acknowledged that the investor-investee relationship changes and, consequently, so does the nature of the investment. However, in this instance, both investments (ie the joint venture and the associate) continue to be measured using the equity method. Considering that there is neither a change in the group boundaries nor a change in the measurement requirements, the Board concluded that losing joint control and retaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.

BC39 Consequently, the Board removed all descriptions that characterise loss of joint control or significant influence as a significant economic event as introduced in the second phase of the Board's project on business combinations.

BC40 The Board also decided to align the conclusions reached on the loss of joint control when significant influence is maintained with the requirements in IAS 21 so that the change from joint control to significant influence is treated as a 'partial' disposal rather than deemed to be an 'entire' disposal. As a consequence, the Board concluded that when an entity loses joint control of a joint arrangement that includes a foreign operation but retains significant influence, an entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income relating to a foreign operation in that joint arrangement.

HKAS 32
Revised ~~July 2012~~May 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Accounting Standard 32

Financial Instruments: Presentation

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

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CONTENTS

Hong Kong Accounting Standard 32 *Financial Instruments: Presentation* (HKAS 32) is set out in paragraphs 2–100 and Application Guidance. All the paragraphs have equal authority. HKAS 32 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing HKAS 32

IN1 Hong Kong Accounting Standard 32 *Financial Instruments: Presentation* (HKAS 32)* should be applied for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 39. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

IN2 The objective of Hong Kong Institute of Certified Public Accountants (HKICPA) issuing HKAS 32 is to maintain international convergence with the International Accounting Standards Board (IASB).

IN3 [Deleted]

The main features

IN4 The main features of HKAS 32 are described below.

Scope

IN5 The scope of HKAS 32 has, where appropriate, been conformed to the scope of HKAS 39.

Principle

IN6 In summary, when an issuer determines whether a financial instrument is a financial liability or an equity instrument, the instrument is an equity instrument if, and only if, both conditions (a) and (b) are met.

(a) The instrument includes no contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

(i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

(ii) a derivative that will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

* In September 2005 the HKICPA amended HKAS 32 by relocating all disclosures relating to financial instruments to HKFRS 7 *Financial Instruments: Disclosures*. In June 2008 the HKICPA amended HKAS 32 by requiring some puttable financial instruments and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.

IN7 In addition, when an issuer has an obligation to purchase its own shares for cash or another financial asset, there is a liability for the amount that the issuer is obliged to pay.

IN8 The definitions of a financial asset and a financial liability, and the description of an equity instrument, are amended consistently with this principle.

Classification of contracts settled in an entity's own equity instruments

IN9 The classification of derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments has been clarified consistently with the principle in paragraph IN6 above. In particular, when an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable instruments

IN10 HKAS 32 incorporates a guidance that a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability of the issuer. In response to comments received on the Exposure Draft, the Standard provides additional guidance and illustrative examples for entities that, because of this requirement, have no equity or whose share capital is not equity as defined in HKAS 32.

Contingent settlement provisions

IN11 HKAS 32 incorporates a conclusion that a financial instrument is a financial liability when the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder. Contingent settlement provisions are ignored when they apply only in the event of liquidation of the issuer or are not genuine.

Settlement options

IN12 Under HKAS 32, a derivative financial instrument is a financial asset or a financial liability when it gives one of the parties to it a choice of how it is settled unless all of the settlement alternatives would result in it being an equity instrument.

Measurement of the components of a compound financial instrument on initial recognition

IN13 Any asset and liability components are separated first and the residual is the amount of any equity component. These requirements for separating the liability and equity components of a compound financial instrument are conformed to both the definition of an equity instrument as a residual and the measurement requirements in HKAS 39.

Treasury shares

IN14 HKAS 32 incorporates a conclusion that the acquisition or subsequent resale by an entity of its own equity instruments does not result in a gain or loss for the entity. Rather it represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument.

Interest, dividends, losses and gains

IN15 HKAS 32 incorporates a guidance that transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of that transaction and are deducted from equity.

Disclosure

IN16–N19 [Deleted]

IN19A In September 2005 the HKICPA revised disclosures about financial instruments and relocated them to HKFRS 7 *Financial Instruments: Disclosures*.

Withdrawal of other pronouncements

IN20 [Deleted]

Potential impact of proposals in exposure drafts

IN21 [Deleted]

Reasons for amending HKAS 32 in June 2008

IN22 In June 2008 the HKICPA amended HKAS 32 by requiring some financial instruments that meet the definition of a financial liability to be classified as equity. Entities should apply the amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

IN23 The amendment addresses the classification of some:

(a) puttable financial instruments, and

(b) instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

IN24 The objective was a short-term, limited scope amendment to improve the financial reporting of particular types of financial instruments that meet the definition of a financial liability but represent the residual interest in the net assets of the entity.

Hong Kong Accounting Standard 32
Financial Instruments: Presentation

Objective

1 [Deleted]

2 The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in HKAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in HKFRS 7 *Financial Instruments: Disclosures*.

Scope

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKFRS 10, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ require or permit~~s~~ an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.

(b) employers' rights and obligations under employee benefit plans, to which HKAS 19 *Employee Benefits* applies.

(c) [deleted]

(d) insurance contracts as defined in HKFRS 4 *Insurance Contracts.* However, this Standard applies to derivatives that are embedded in insurance contracts if HKAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies HKAS 39 in recognising and measuring the contracts, but shall apply HKFRS 4 if the issuer elects, in accordance with paragraph 4(d) of HKFRS 4, to apply HKFRS 4 in recognising and measuring them.

(e) financial instruments that are within the scope of HKFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15–32 and AG25–AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see HKAS 39).

(f) **financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2 *Share-based Payment* applies, except for**

(i) **contracts within the scope of paragraphs 8–10 of this Standard, to which this Standard applies,**

(ii) **paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

5-7 [Deleted]

8 **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.**

9 There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

(d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 8 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirement, and accordingly, whether they are within the scope of this Standard.

10 A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 9(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions (see also paragraphs AG3-AG23)

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

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

A *financial asset* **is any asset that is:**

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

A *financial liability* **is any liability that is:**

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

An *equity instrument* **is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.**

Fair value **~~is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.~~ is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)**

A *puttable instrument* **is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.**

12 The following terms are defined in paragraph 9 of HKAS 39 and are used in this Standard with the meaning specified in HKAS 39.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- financial asset or financial liability at fair value through profit or loss
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale
- transaction costs.

13 In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

14 In this Standard, 'entity' includes individuals, partnerships, incorporated bodies, trusts and government agencies.

Presentation

Liabilities and equity (see also paragraphs AG13–AG14J and AG25–AG29A)

15 The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.

16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) The instrument includes no contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

(i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

Puttable instruments

16A A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the entity's net assets on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) has no priority over other claims to the assets of the entity on liquidation, and

(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.

(d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.

(e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

16B For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and

(b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16A that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

16C Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the net assets of the entity on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) has no priority over other claims to the assets of the entity on liquidation, and

(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.

16D For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and

(b) the effect of substantially restricting or fixing the residual return to the instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16C that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Reclassification of puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

16E An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all the features and meet all the conditions in paragraphs 16A and 16B, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

16F An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 16E:

(a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognise in equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.

(b) It shall reclassify a financial liability as equity from the date when the instrument has all the features and meets the conditions set out in paragraphs 16A and 16B or paragraphs 16C and 16D. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

No contractual obligation to deliver cash or another financial asset (paragraph 16(a))

17 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

18 The substance of a financial instrument, rather than its legal form, governs its classification in the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

(a) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

(b) a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).

19 If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example:

(a) a restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.

(b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

20 A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:

(a) a financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.

(b) a financial instrument is a financial liability if it provides that on settlement the entity will deliver either:

(i) cash or another financial asset; or

(ii) its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 21).

Settlement in the entity's own equity instruments (paragraph 16(b))

21 A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (e.g. an interest rate, a commodity price or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100,[*] and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

22 Except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

22A If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all the features and meeting the conditions described in paragraphs 16A and 16B, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all the features and meeting the conditions described in paragraphs 16C and 16D, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

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

23 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. ~~When the~~The financial liability is recognised initially ~~under HKAS 39, its fair value (~~at the present value of the redemption amount~~)~~ and is reclassified from equity. Subsequently, the financial liability is measured in accordance with HKAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g. a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

24 A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold.

Contingent settlement provisions

25 A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

(a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or

(c) the instrument has all the features and meets the conditions in paragraphs 16A and 16B.

Settlement options

26 When a derivative financial instrument gives one party a choice over how it is settled (e.g. the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.

27 An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the

non-financial item or net in cash or another financial instrument (see paragraphs 8-10). Such contracts are financial assets or financial liabilities and not equity instruments.

Compound financial instruments (see also paragraphs AG30-AG35 and Illustrative Examples 9-12)

28 The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.

29 An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately in its statement of financial position.

30 Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.

31 HKAS 39 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

32 Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Treasury shares (see also paragraph AG36)

33 If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.

34 The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with HKAS 1 *Presentation of Financial Statements*. An entity provides disclosure in accordance with HKAS 24 *Related Party Disclosures* if the entity reacquires its own equity instruments from related parties.

Interest, dividends, losses and gains (see also paragraph AG37)

35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised~~debited~~ by the entity directly in~~to~~ equity~~, net of any related income tax benefit~~. Transaction costs of an equity transaction shall be accounted for as a deduction from equity~~, net of any related income tax benefit~~.

35A Income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction shall be accounted for in accordance with HKAS 12 *Income Taxes.*

36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

37 An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity~~ (net of any related income tax benefit)~~ to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.

38 Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately ~~under~~in accordance with HKAS 1. ~~The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under HKAS 12 *Income Taxes*.~~

40 Dividends classified as an expense may be presented in the statement(s) of profit or loss and other comprehensive income ~~or separate income statement (if presented)~~ either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of HKAS 1 and HKFRS 7. In some circumstances, because of the differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement(s) of profit or loss and other comprehensive income~~ or separate income statement (if presented)~~. Disclosures of the tax effects are made in accordance with HKAS 12.

41 Gains and losses related to changes in the carrying amount of a financial liability are recognised as income or expense in profit or loss even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 18(b)). Under HKAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of comprehensive income when it is relevant in explaining the entity's performance.

Offsetting a financial asset and a financial liability (see also paragraphs AG38 and AG39)

42 A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see HKAS 39, paragraph 36).

43 This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. An entity shall disclose the information required in paragraphs 13B-13E of HKFRS 7 for recognised financial instruments that are within the scope of paragraph 13A of HKFRS 7.

44 Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss.

45 A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

46 The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

47 An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 36 of HKFRS 7.

48 Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organised financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realisation of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.

49 The conditions set out in paragraph 42 are generally not satisfied and offsetting is usually inappropriate when:

(a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');

(b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;

(c) financial or other assets are pledged as collateral for non-recourse financial liabilities;

(d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or

(e) obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.

50 An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 42 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 36 of HKFRS 7.

Disclosure

51-95 [Deleted]

Effective date and transition

96 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 39. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

96A *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to HKAS 32 and HKAS 1), issued in June 2008, required financial instruments that contain all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D to be classified as an equity instrument, amended paragraphs 11, 16, 17–19, 22, 23, 25, AG13, AG14 and AG27, and inserted paragraphs 16A–16F, 22A, 96B, 96C, 97C, AG14A–AG14J and AG29A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the changes for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 1, HKAS 39, HKFRS 7 and HK(IFRIC)-Int 2 at the same time.

96B *Puttable Financial Instruments and Obligations Arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy.

96C The classification of instruments under this exception shall be restricted to the accounting for such an instrument under HKAS 1, HKAS 32, HKAS 39 and HKFRS 7. The instrument shall not be considered an equity instrument under other guidance, for example HKFRS 2.

97 This Standard shall be applied retrospectively, and accounting policies adopted in respect of each period presented shall be disclosed. When comparative information for prior periods is not available when this Standard is first applied, such information need not be presented, but an entity shall disclose that fact.

97A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 40. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

97B HKFRS 3 *Business Combinations* (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. However, the amendment does not apply to contingent consideration that arose from a business combination for which the acquisition date preceded the application of HKFRS 3 (revised 2008). Instead, an entity shall account for such consideration in accordance with paragraphs 65A–65E of HKFRS 3 (as amended in 2010).

97C When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to HKAS 32 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.

97D Paragraph 4 was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 3 of HKFRS 7, paragraph 1 of HKAS 28 and paragraph 1 of HKAS 31 issued in October 2008. An entity is permitted to apply the amendment prospectively.

97E Paragraphs 11 and 16 were amended by *Classification of Rights Issues* issued in October 2009. An entity shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

97F *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

97G Paragraph 97B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

97H *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

97I HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 4(a) and AG29. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

97J HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 11 and amended paragraphs 23 and AG31. An entity shall apply those amendments when it applies HKFRS 13.

97K *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraph 40. An entity shall apply that amendment when it applies HKAS 1 as amended in July 2011.

97L *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

97M *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to HKFRS 7), issued in December 2011, amended paragraph 43 by requiring an entity to disclose the information required in paragraphs 13B–13E of HKFRS 7 for recognised financial assets that are within the scope of paragraph 13A of HKFRS 7. An entity shall apply that amendment for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. An entity shall provide the disclosures required by this amendment retrospectively.

97N *Annual Improvements 2009–2011 Cycle*, issued in June 2012, amended paragraphs 35, 37 and 39 and added paragraph 35A. An entity shall apply that amendment retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Withdrawal of Other Pronouncements

98 This Standard, together with HKAS 39 *Financial Instruments: Recognition and Measurement*, supersede SSAP 24 Accounting for Investments in Securities issued in 1999.*

* In September 2005 the Institute relocated all disclosures relating to financial instruments to HKFRS 7 *Financial Instruments: Disclosures*.

Appendix A

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at 20 April 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 32.

The International Accounting Standard comparable with HKAS 32 is IAS 32 *Financial Instruments: Presentation*.

There are no major textual differences between HKAS 32 and IAS 32.

Appendix ~~C~~B

Amendments to HKAS 32 *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2014

The following sets out amendment required for this Standard resulting from amendments to HKAS 32 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Effective date and transition

Paragraph 97L is added.

97L *Offsetting Financial Assets and Financial Liabilities* (Amendments to HKAS 32), issued in December 2011, deleted paragraph AG38 and added paragraphs AG38A–AG38F. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. An entity shall apply those amendments retrospectively. Earlier application is permitted. If an entity applies those amendments from an earlier date, it shall disclose that fact and shall also make the disclosures required by *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to HKFRS 7) issued in December 2011.

Application Guidance

Immediately after the heading 'Offsetting a financial asset and a financial liability (paragraphs 42–50)', paragraph AG38 is deleted. Headings and paragraphs AG38A–AG38F are added.

Criterion that an entity 'currently has a legally enforceable right to set off the recognised amounts' (paragraph 42(a))

AG38A A right of set-off may be currently available or it may be contingent on a future event (for example, the right may be triggered or exercisable only on the occurrence of some future event, such as the default, insolvency or bankruptcy of one of the counterparties). Even if the right of set-off is not contingent on a future event, it may only be legally enforceable in the normal course of business, or in the event of default, or in the event of insolvency or bankruptcy, of one or all of the counterparties.

AG38B To meet the criterion in paragraph 42(a), an entity must currently have a legally enforceable right of set-off. This means that the right of set-off:

(a) must not be contingent on a future event; and

(b) must be legally enforceable in all of the following circumstances:

(i) the normal course of business;

(ii) the event of default; and

(iii) the event of insolvency or bankruptcy

of the entity and all of the counterparties.

AG38C The nature and extent of the right of set-off, including any conditions attached to its exercise and whether it would remain in the event of default or insolvency or bankruptcy, may vary from one legal jurisdiction to another. Consequently, it cannot be assumed that the right of set-off is automatically available outside of the normal course of business. For example, the bankruptcy or insolvency laws of a jurisdiction may prohibit, or restrict, the right of set-off in the event of bankruptcy or insolvency in some circumstances.

AG38D The laws applicable to the relationships between the parties (for example, contractual provisions, the laws governing the contract, or the default, insolvency or bankruptcy laws applicable to the parties) need to be considered to ascertain whether the right of set-off is enforceable in the normal course of business, in an event of default, and in the event of insolvency or bankruptcy, of the entity and all of the counterparties (as specified in paragraph AG38B(b)).

Criterion that an entity 'intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously' (paragraph 42(b))

AG38E To meet the criterion in paragraph 42(b) an entity must intend either to settle on a net basis or to realise the asset and settle the liability simultaneously. Although the entity may have a right to settle net, it may still realise the asset and settle the liability separately.

AG38F If an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion in paragraph 42(b). This will occur if, and only if, the gross settlement mechanism has features that eliminate or result in insignificant credit and liquidity risk, and that will process receivables and payables in a single settlement process or cycle. For example, a gross settlement system that has all of the following characteristics would meet the net settlement criterion in paragraph 42(b):

(a) financial assets and financial liabilities eligible for set-off are submitted at the same point in time for processing;

(b) once the financial assets and financial liabilities are submitted for processing, the parties are committed to fulfil the settlement obligation;

(c) there is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing (unless the processing fails—see (d) below);

(d) assets and liabilities that are collateralised with securities will be settled on a securities transfer or similar system (for example, delivery versus payment), so that if the transfer of securities fails, the processing of the related receivable or payable for which the securities are collateral will also fail (and vice versa);

(e) any transactions that fail, as outlined in (d), will be re-entered for processing until they are settled;

(f) settlement is carried out through the same settlement institution (for example, a settlement bank, a central bank or a central securities depository); and

(g) an intraday credit facility is in place that will provide sufficient overdraft amounts to enable the processing of payments at the settlement date for each of the parties, and it is virtually certain that the intraday credit facility will be honoured if called upon.

Appendix
Application Guidance
HKAS 32 *Financial Instruments: Presentation*

This appendix is an integral part of the Standard.

AG1 This Application Guidance explains the application of particular aspects of the Standard.

AG2 The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in HKAS 39.

Definitions (paragraphs 11-14)

Financial assets and financial liabilities

AG3 Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.

AG4 Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

(a) trade accounts receivable and payable;

(b) notes receivable and payable;

(c) loans receivable and payable; and

(d) bonds receivable and payable.

In each case, one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).

AG5 Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.

AG6 'Perpetual' debt instruments (such as 'perpetual' bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000.* Assuming 8 per cent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

AG7 A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.

AG8 The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of HKFRS 4.

AG9 Under HKAS 17 *Leases* a finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).

AG10 Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

AG11 Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.

AG12 Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets. Accounting for income taxes is dealt with in HKAS 12. Similarly, constructive obligations, as defined in HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* do not arise from contracts and are not financial liabilities.

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

Equity instruments

AG13 Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A and 16B), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 16C and 16D), some types of preference shares (see paragraphs AG25 and AG26), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity's obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 22A). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

AG14 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 22A). Instead, any consideration paid for such a contract is deducted from equity.

The class of instruments that is subordinate to all other classes (paragraphs 16A(b) and 16C(b))

AG14A One of the features of paragraphs 16A and 16C is that the financial instrument is in the class of instruments that is subordinate to all other classes.

AG14B When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes.

AG14C An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation.

AG14D If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes.

Total expected cash flows attributable to the instrument over the life of the instrument (paragraph 16A(e))

AG14E The total expected cash flows of the instrument over the life of the instrument must be substantially based on the profit or loss, change in the recognised net assets or fair value of the recognised and unrecognised net assets of the entity over the life of the instrument. Profit or loss and the change in the recognised net assets shall be measured in accordance with relevant HKFRSs.

Transactions entered into by an instrument holder other than as owner of the entity (paragraphs 16A and 16C)

AG14F The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder may also be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as equity under paragraph 16A or paragraph 16C.

AG14G An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.

AG14H Another example is a profit or loss sharing arrangement that allocates profit or loss to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 16A or paragraph 16C. However, profit or loss sharing arrangements that allocate profit or loss to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 16A or paragraph 16C.

AG14I The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

No other financial instrument or contract with total cash flows that substantially fixes or restricts the residual return to the instrument holder (paragraphs 16B and 16D)

AG14J A condition for classifying as equity a financial instrument that otherwise meets the criteria in paragraph 16A or paragraph 16C is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph 16A or paragraph 16C from being classified as equity:

(a) instruments with total cash flows substantially based on specific assets of the entity.

(b) instruments with total cash flows based on a percentage of revenue.

(c) contracts designed to reward individual employees for services rendered to the entity.

(d) contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

Derivative financial instruments

AG15 Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.

AG16 Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally[*] do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favourable or unfavourable.

AG17 A put or call option to exchange financial assets or financial liabilities (i.e. financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favourable conditions and the writer's obligation to exchange the financial asset under potentially unfavourable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

[*] This is true of most, but not all derivatives, e.g. in some cross-currency interest rate swaps principal is exchanged on inception (and re-exchanged on maturity).

AG18 Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

AG19 Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardised and traded on an exchange.

Contracts to buy or sell non-financial items (paragraphs 8-10)

AG20 Contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. For example, contracts that provide for settlement only by the receipt or delivery of a non-financial item (e.g. an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardised in form and traded on organised markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 8).

AG21 A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.

AG22 Some contracts are commodity-linked, but do not involve settlement through the physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price, but is settled only in cash. Such a contract constitutes a financial instrument.

AG23 The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.

AG24 [Deleted]

Presentation

Liabilities and equity (paragraphs 15-27)

No contractual obligation to deliver cash or another financial asset (paragraphs 17-20)

AG25 Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.

AG26 When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:

(a) a history of making distributions;

(b) an intention to make distributions in the future;

(c) a possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);

(d) the amount of the issuer's reserves;

(e) an issuer's expectation of a profit or loss for a period; or

(f) an ability or inability of the issuer to influence the amount of its profit or loss for the period.

Settlement in the entity's own equity instruments (paragraphs 21-24)

AG27 The following examples illustrate how to classify different types of contracts on an entity's own equity instruments:

(a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 22A). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognises a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.

(b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.

(c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is a net cash-settled share option.

(d) A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than gold. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

Contingent settlement provisions (paragraph 25)

AG28 Paragraph 25 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

Treatment in Consolidated Financial Statements

AG29 In consolidated financial statements, an entity presents non-controlling interests—i.e. the interests of other parties in the equity and income of its subsidiaries—in accordance with HKAS 1 and ~~HKAS 27~~HKFRS 10. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the group and the holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a subsidiary in a group issues a financial instrument and a parent or other group entity agrees additional terms directly with the holders of the instrument (e.g. a guarantee), the group may not have discretion over distributions or redemption. Although the subsidiary may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the group and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the group as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

AG29A Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 16A and 16B or paragraphs 16C and 16D in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the group.

Compound financial instruments (paragraphs 28-32)

AG30 Paragraph 28 applies only to issuers of non-derivative compound financial instruments. Paragraph 28 does not deal with compound financial instruments from the perspective of holders. HKAS 39 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and equity features.

AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the statement of financial position, as follows:

(a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

(b) The equity instrument is an embedded option to convert the liability into equity of the issuer. ~~The fair value of the option comprises its time value and its intrinsic value, if any.~~ This option has value on initial recognition even when it is out of the money.

AG32 On conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.

AG33 When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and equity components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 28-32.

AG34 Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:

(a) the amount of gain or loss relating to the liability component is recognised in profit or loss; and

(b) the amount of consideration relating to the equity component is recognised in equity.

AG35 An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favourable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognised as a loss in profit or loss.

Treasury shares (paragraphs 33 and 34)

AG36 An entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired. Paragraph 33 requires an entity that reacquires its own equity instruments to deduct those equity instruments from equity. However, when an entity holds its own equity on behalf of others, e.g. a financial institution holding its own equity on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

Interest, dividends, losses and gains (paragraphs 35-41)

AG37 The following example illustrates the application of paragraph 35 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognised in profit or loss and classified as interest expense. Any dividends paid relate to the equity component and, accordingly, are recognised as a distribution of profit or loss. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (e.g. commodity). However, if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends are classified as interest expense.

Offsetting a financial asset and a financial liability (paragraphs 42-50)

AG38 To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognised amounts. An entity may have a conditional right to set off recognised amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.

AG39 The Standard does not provide special treatment for so-called 'synthetic instruments', which are groups of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate long-term debt. Each of the individual financial instruments that together constitute a 'synthetic instrument' represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a 'synthetic instrument' is an asset and another is a liability, they are not offset and presented in an entity's statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 42.

Disclosure

Financial assets and financial liabilities at fair value through profit or loss (paragraph 94(f))

AG40 [Deleted]

HKAS 32 BC
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Effective for annual periods
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Basis for Conclusions on
Hong Kong Accounting Standard 32

Financial Instruments:

Presentation

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

Basis for Conclusions
IAS 32 *Financial Instruments: Presentation*

HKAS 32 is based on IAS 32 *Financial Instruments: Presentation*. In approving HKAS 32, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 32. Accordingly, there are no significant differences between HKAS 32 and IAS 32. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 32 referred to below generally correspond with those in HKAS 32.

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Amendments to Basis for Conclusions on IAS 32

Basis for Conclusions on IAS 32 *Financial Instruments: Presentation*

This Basis for Conclusions accompanies, but is not part of, IAS 32.

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

BC1 This Basis for Conclusions summarises the International Accounting Standard Board's considerations in reaching its conclusions on revising IAS 32 *Financial Instruments: Disclosure and Presentation*[*] in 2003. Individual Board members gave greater weight to some factors than to others.

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. The objectives of the Improvements project were to reduce the complexity in the Standards by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance. In June 2002 the Board published its proposals in an Exposure Draft of proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*, with a comment deadline of 14 October 2002. The Board received over 170 comment letters on the Exposure Draft.

BC3 Because the Board did not reconsider the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39, this Basis for Conclusions does not discuss requirements in IAS 32 that the Board has not reconsidered.

BC3A In July 2006 the Board published an exposure draft of proposed amendments to IAS 32 relating to the classification of puttable instruments and instruments with obligations arising on liquidation. The Board subsequently confirmed the proposals and in 2008 issued an amendment that now forms part of IAS 32. A summary of the Board's considerations and reasons for its conclusions is in paragraphs BC50–BC74.

Definitions (paragraphs 11-14 and AG3-AG24)

Financial asset, financial liability and equity instrument (paragraphs 11 and AG3 – AG14)

BC4 The revised IAS 32 addresses the classification as financial assets, financial liabilities or equity instruments of financial instruments that are indexed to, or settled in, an entity's own equity instruments. As discussed further in paragraphs BC6–BC15, the Board decided to preclude equity classification for such contracts when they (a) involve an obligation to deliver cash or another financial asset or to exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity, (b) in the case of a non-derivative, are not for the receipt or delivery of a fixed number of shares or (c) in the case of a derivative, are not for the exchange of a fixed number of shares for a fixed amount of cash or another financial asset. The Board also decided to preclude equity classification for contracts that are derivatives on derivatives on an entity's own equity. Consistently with this decision, the Board also decided to amend the definitions of financial asset, financial liability and equity instrument in IAS 32 to make them consistent with the guidance about contracts on an entity's own equity instruments. The Board did not reconsider other aspects of the definitions as part of this project to revise IAS 32, for example the other changes to the definitions proposed by the Joint Working Group in its Draft Standard *Financial Instruments and Similar Items* published by the Board's predecessor body, IASC, in 2000.

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7. The paragraphs relating to disclosures that were originally published in this Basis for Conclusions were relocated, if still relevant, to the Basis for Conclusions on IFRS 7.

Foreign currency denominated pro rata rights issues

BC4A In 2005 the International Financial Reporting Interpretations Committee (IFRIC) was asked whether the equity conversion option embedded in a convertible bond denominated in a foreign currency met IAS 32's requirements to be classified as an equity instrument. IAS 32 states that a derivative instrument relating to the purchase or issue of an entity's own equity instruments is classified as equity only if it results in the exchange of a fixed number of equity instruments for a fixed amount of cash or other assets. At that time, the IFRIC concluded that if the conversion option was denominated in a currency other than the issuing entity's functional currency, the amount of cash to be received in the functional currency would be variable. Consequently, the instrument was a derivative liability that should be measured at its fair value with changes in fair value included in profit or loss.

BC4B However, the IFRIC also concluded that this outcome was not consistent with the Board's approach when it introduced the 'fixed for fixed' notion in IAS 32. Therefore, the IFRIC decided to recommend that the Board amend IAS 32 to permit a conversion or stand-alone option to be classified as equity if the exercise price was fixed in any currency. In September 2005 the Board decided not to proceed with the proposed amendment.

BC4C In 2009 the Board was asked by the IFRIC to consider a similar issue. This issue was whether a right entitling the holder to receive a fixed number of the issuing entity's own equity instruments for a fixed amount of a currency other than the issuing entity's functional currency (foreign currency) should be accounted for as a derivative liability.

BC4D These rights are commonly described as 'rights issues' and include rights, options and warrants. Laws or regulations in many jurisdictions throughout the world require the use of rights issues when raising capital. The entity issues one or more rights to acquire a fixed number of additional shares pro rata to all existing shareholders of a class of non-derivative equity instruments. The exercise price is normally below the current market price of the shares. Consequently, a shareholder must exercise its rights if it does not wish its proportionate interest in the entity to be diluted. Issues with those characteristics are discussed in IFRS 2 *Share-based Payment* and IAS 33 *Earnings per Share*.

BC4E The Board was advised that rights with the characteristics discussed above were being issued frequently in the current economic environment. The Board was also advised that many issuing entities fixed the exercise price of the rights in currencies other than their functional currency because the entities were listed in more than one jurisdiction and might be required to do so by law or regulation. Therefore, the accounting conclusions affected a significant number of entities in many jurisdictions. In addition, because these are usually relatively large transactions, they can have a substantial effect on entities' financial statement amounts.

BC4F The Board agreed with the IFRIC's 2005 conclusion that a contract with an exercise price denominated in a foreign currency would not result in the entity receiving a fixed amount of cash. However, the Board also agreed with the IFRIC that classifying rights as derivative liabilities was not consistent with the substance of the transaction. Rights issues are issued only to existing shareholders on the basis of the number of shares they already own. In this respect they partially resemble dividends paid in shares.

BC4G The Board decided that a financial instrument that gives the holder the right to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency is an equity instrument if, and only if, the entity offers the financial instrument pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.

BC4H In excluding grants of rights with these features from the scope of IFRS 2, the Board explicitly recognised that the holder of the right receives it as a holder of equity instruments, ie as an owner. The Board noted that IAS 1 *Presentation of Financial Statements* requires transactions with owners in their capacity as owners to be recognised in the statement of changes in equity rather than in the statement of comprehensive income.

BC4I Consistently with its conclusion in IFRS 2, the Board decided that a pro rata issue of rights to all existing shareholders to acquire additional shares is a transaction with an entity's owners in their capacity as owners. Consequently, those transactions should be recognised in equity, not comprehensive income. Because the Board concluded that the rights were equity instruments, it decided to amend the definition of a financial liability to exclude them.

BC4J Some respondents to the exposure draft expressed concerns that the wording of the amendment was too open-ended and could lead to structuring risks. The Board rejected this argument because of the extremely narrow amendment that requires the entity to treat all of its existing owners of the same class of its own non-derivative equity instruments equally. The Board also noted that a change in the capital structure of an entity to create a new class of non-derivative equity instruments would be transparent because of the presentation and disclosure requirements in IFRSs.

BC4K The Board decided not to extend this conclusion to other instruments that grant the holder the right to purchase the entity's own equity instruments such as the conversion feature in convertible bonds. The Board also noted that long-dated foreign currency rights issues are not primarily transactions with owners in their capacity as owners. The equal treatment of all owners of the same class of equity instruments was also the basis on which, in IFRIC 17 *Distributions of Non-cash Assets to Owners*, the IFRIC distinguished non-reciprocal distributions to owners from exchange transactions. The fact that the rights are distributed pro rata to existing shareholders is critical to the Board's conclusion to provide an exception to the 'fixed for fixed' concept in IAS 32 as this is a narrow targeted transaction with owners in their capacity as owners.

Presentation (paragraphs 15-50 and AG25-AG39)

Liabilities and equity (paragraphs 15-27 and AG25-AG29)

BC5 The revised IAS 32 addresses whether derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments are financial assets, financial liabilities or equity instruments. The original IAS 32 dealt with aspects of this issue piecemeal and it was not clear how various transactions (e.g. net share settled contracts and contracts with settlement options) should be treated under the Standard. The Board concluded that it needed to clarify the accounting treatment for such transactions.

BC6 The approach agreed by the Board can be summarised as follows:

A contract on an entity's own equity is an equity instrument if, and only if:

(a) it contains no contractual obligation to transfer cash or another financial asset, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; and

(b) if the instrument will or may be settled in the entity's own equity instruments, it is either (i) a non-derivative that includes no contractual obligation for the entity to deliver a variable number of its own equity instruments, or (ii) a derivative that will be settled by the entity exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

No contractual obligation to deliver cash or another financial asset (paragraphs 17-20 and AG25-AG26)

Puttable Instruments (paragraph 18(b))

BC7 The Board decided that a financial instrument that gives the holder the right to put the instrument back to the entity for cash or another financial asset is a financial liability of the entity. Such financial instruments are commonly issued by mutual funds, unit trusts, co-operative and similar entities, often with the redemption amount being equal to a proportionate share in the net assets of the entity. Although the legal form of such financial instruments often includes a right to the residual interest in the assets of an entity available to holders of such instruments, the inclusion of an option for the holder to put the instrument back to the entity for cash or another financial asset means that the instrument meets the definition of a financial liability. The classification as a financial liability is independent of considerations such as when the right is exercisable, how the amount payable or receivable upon exercise of the right is determined, and whether the puttable instrument has a fixed maturity.

BC7A The Board reconsidered its conclusions with regards to some puttable instruments and amended IAS 32 in February 2008 (see paragraphs BC50–BC74).

BC8 The Board noted that the classification of a puttable instrument as a financial liability does not preclude the use of descriptors such as 'net assets attributable to unitholders' and 'change in net assets attributable to unitholders' on the face of the financial statements of an entity that has no equity (such as some mutual funds and unit trusts) or whose share capital is a financial liability under IAS 32 (such as some co-operatives). The Board also agreed that it should provide examples of how such entities might present their income statement[*] and balance sheet[♦] (see Illustrative Examples 7 and 8).

Implicit obligations (paragraph 20)

BC9 The Board did not debate whether an obligation can be established implicitly rather than explicitly because this is not within the scope of an improvements project. This question will be considered by the Board in its project on revenue, liabilities and equity. Consequently, the Board retained the existing notion that an instrument may establish an obligation indirectly through its terms and conditions (see paragraph 20). However, it decided that the example of a preference share with a contractually accelerating dividend which, within the foreseeable future, is scheduled to yield a dividend so high that the entity will be economically compelled to redeem the instrument, was insufficiently clear. The example was therefore removed and replaced with others that are clearer and deal with situations that have proved problematic in practice.

Settlement in the entity's own equity instruments (paragraphs 21-24 and AG27)

BC10 The approach taken in the revised IAS 32 includes two main conclusions:

(a) When an entity has an obligation to purchase its own shares for cash (such as under a forward contract to purchase its own shares), there is a financial liability for the amount of cash that the entity has an obligation to pay.

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[*] IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

[♦] IAS 1 (revised 2007) replaced the term 'balance sheet' with 'statement of financial position'.

(b) When an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability. In other words, when a contract is settled in a variable number of the entity's own equity instruments, or by the entity exchanging a fixed number of its own equity instruments for a variable amount of cash or another financial asset, the contract is not an equity instrument but is a financial asset or a financial liability.

When an entity has an obligation to purchase its own shares for cash, there is a financial liability for the amount of cash that the entity has an obligation to pay.

BC11 An entity's obligation to purchase its own shares establishes a maturity date for the shares that are subject to the contract. Therefore, to the extent of the obligation, those shares cease to be equity instruments when the entity assumes the obligation. This treatment under IAS 32 is consistent with the treatment of shares that provide for mandatory redemption by the entity. Without a requirement to recognise a financial liability for the present value of the share redemption amount, entities with identical obligations to deliver cash in exchange for their own equity instruments could report different information in their financial statements depending on whether the redemption clause is embedded in the equity instrument or is a free-standing derivative contract.

BC12 Some respondents to the Exposure Draft suggested that when an entity writes an option that, if exercised, will result in the entity paying cash in return for receiving its own shares, it is incorrect to treat the full amount of the exercise price as a financial liability because the obligation is conditional upon the option being exercised. The Board rejected this argument because the entity has an obligation to pay the full redemption amount and cannot avoid settlement in cash or another financial asset for the full redemption amount unless the counterparty decides not to exercise its redemption right or specified future events or circumstances beyond the control of the entity occur or do not occur. The Board also noted that a change would require a reconsideration of other provisions in IAS 32 that require liability treatment for obligations that are conditional on events or choices that are beyond the entity's control. These include, for example, (a) the treatment of financial instruments with contingent settlement provisions as financial liabilities for the full amount of the conditional obligation, (b) the treatment of preference shares that are redeemable at the option of the holder as financial liabilities for the full amount of the conditional obligation, and (c) the treatment of financial instruments (puttable instruments) that give the holder the right to put the instrument back to the issuer for cash or another financial asset, the amount of which is determined by reference to an index, and which therefore has the potential to increase and decrease, as financial liabilities for the full amount of the conditional obligation.

When an entity uses its own equity instruments as currency in a contract to receive or deliver a variable number of shares, the contract is not an equity instrument, but is a financial asset or a financial liability.

BC13 The Board agreed that it would be inappropriate to account for a contract as an equity instrument when an entity's own equity instruments are used as currency in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a net share-settled derivative contract on gold or an obligation to deliver as many shares as are equal in value to CU10,000). Such a contract represents a right or obligation of a specified amount rather than a specified equity interest. A contract to pay or receive a specified amount (rather than a specified equity interest) is not an equity instrument. For such a contract, the entity does not know, before the transaction is settled, how many of its own shares (or how much cash) it will receive or deliver and the entity may not even know whether it will receive or deliver its own shares.

BC14 In addition, the Board noted that precluding equity treatment for such a contract limits incentives for structuring potentially favourable or unfavourable transactions to obtain equity treatment. For example, the Board believes that an entity should not be able to obtain equity treatment for a transaction simply by including a share settlement clause when the contract is for a specified value, rather than a specified equity interest.

BC15 The Board rejected the argument that a contract that is settled in the entity's own shares must be an equity instrument because no change in assets or liabilities, and thus no gain or loss, arises on settlement of the contract. The Board noted that any gain or loss arises before settlement of the transaction, not when it is settled.

Contingent settlement provisions (paragraphs 25 and AG28)

BC16 The revised Standard incorporates the conclusion previously in SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions* that a financial instrument for which the manner of settlement depends on the occurrence or non-occurrence of uncertain future events, or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder (i.e. a 'contingent settlement provision'), is a financial liability.

BC17 The amendments do not include the exception previously provided in paragraph 6 of SIC-5 for circumstances in which the possibility of the entity being required to settle in cash or another financial asset is remote at the time the financial instrument is issued. The Board concluded that it is not consistent with the definitions of financial liabilities and equity instruments to classify an obligation to deliver cash or another financial asset as a financial liability only when settlement in cash is probable. There is a contractual obligation to transfer economic benefits as a result of past events because the entity is unable to avoid a settlement in cash or another financial asset unless an event occurs or does not occur in the future.

BC18 However, the Board also concluded that contingent settlement provisions that would apply only in the event of liquidation of an entity should not influence the classification of the instrument because to do so would be inconsistent with a going concern assumption. A contingent settlement provision that provides for payment in cash or another financial asset only on the liquidation of the entity is similar to an equity instrument that has priority in liquidation and therefore should be ignored in classifying the instrument.

BC19 Additionally, the Board decided that if the part of a contingent settlement provision that could require settlement in cash or a variable number of own shares is not genuine, it should be ignored for the purposes of classifying the instrument. The Board also agreed to provide guidance on the meaning of 'genuine' in this context (see paragraph AG28).

Settlement options (paragraphs 26 and 27)

BC20 The revised Standard requires that if one of the parties to a contract has one or more options as to how it is settled (e.g. net in cash or by exchanging shares for cash), the contract is a financial asset or a financial liability unless all of the settlement alternatives would result in equity classification. The Board concluded that entities should not be able to circumvent the accounting requirements for financial assets and financial liabilities simply by including an option to settle a contract through the exchange of a fixed number of shares for a fixed amount. The Board had proposed in the Exposure Draft that past practice and management intentions should be considered in determining the classification of such instruments. However, respondents to the Exposure Draft noted that such requirements can be difficult to apply because some entities do not have any history of similar transactions and the assessment of whether an established practice exists and of what is management's intention can be subjective. The Board agreed with these comments and accordingly concluded that past practice and management intentions should not be determining factors.

Alternative approaches considered

BC21 In finalising the revisions to IAS 32 the Board considered, but rejected, a number of alternative approaches:

(a) To classify as an equity instrument any contract that will be settled in the entity's own shares. The Board rejected this approach because it does not deal adequately with transactions in which an entity is using its own shares as currency, e.g. when an entity has an obligation to pay a fixed or determinable amount that is settled in a variable number of its own shares.

(b) To classify a contract as an equity instrument only if (i) the contract will be settled in the entity's own shares, and (ii) the changes in the fair value of the contract move in the same direction as the changes in the fair value of the shares from the perspective of the counterparty. Under this approach, contracts that will be settled in the entity's own shares would be financial assets or financial liabilities if, from the perspective of the counterparty, their value moves inversely with the price of the entity's own shares. An example is an entity's obligation to buy back its own shares. The Board rejected this approach because its adoption would represent a fundamental shift in the concept of equity. The Board also noted that it would result in a change to the classification of some transactions, compared with the existing *Framework*[#] and IAS 32, that had not been exposed for comment.

(c) To classify as an equity instrument a contract that will be settled in the entity's own shares unless its value changes in response to something other than the price of the entity's own shares. The Board rejected this approach to avoid an exception to the principle that non-derivative contracts that are settled in a variable number of an entity's own shares should be treated as financial assets or financial liabilities.

(d) To limit classification as equity instruments to outstanding ordinary shares, and classify as financial assets or financial liabilities all contracts that involve future receipt or delivery of the entity's own shares. The Board rejected this approach because its adoption would represent a fundamental shift in the concept of equity. The Board also noted that it would result in a change to the classification of some transactions compared with the existing IAS 32 that had not been exposed for comment.

Compound financial instruments (paragraphs 28-32 and AG30-AG35)

BC22 The Standard requires the separate presentation in an entity's balance sheet[*] of liability and equity components of a single financial instrument. It is more a matter of form than a matter of substance that both liabilities and equity interests are created by a single financial instrument rather than two or more separate instruments. The Board believes that an entity's financial position is more faithfully represented by separate presentation of liability and equity components contained in a single instrument.

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

[*] IAS 1 (as revised in 2007) replaced the term "balance sheet" with "statement of financial position".

Allocation of the initial carrying amount to the liability and equity components (paragraphs 31, 32 and AG36-AG38 and Illustrative Examples 9-12)

BC23 The previous version of IAS 32 did not prescribe a particular method for assigning the initial carrying amount of a compound financial instrument to its separated liability and equity components. Rather, it suggested approaches that might be considered, such as:

(a) assigning to the less easily measurable component (often the equity component) the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily determinable (a 'with-and-without' method); and

(b) measuring the liability and equity components separately and, to the extent necessary, adjusting these amounts pro rata so that the sum of the components equals the amount of the instrument as a whole (a 'relative fair value' method).

BC24 This choice was originally justified on the grounds that IAS 32 did not deal with the measurement of financial assets, financial liabilities and equity instruments.

BC25 However, since the issue of IAS 39, IFRSs contain requirements for the measurement of financial assets and financial liabilities. Therefore, the view that IAS 32 should not prescribe a particular method for separating compound financial instruments because of the absence of measurement requirements for financial instruments is no longer valid. IAS 39, paragraph 43, requires a financial liability to be measured on initial recognition at its fair value. Therefore, a relative fair value method could result in an initial measurement of the liability component that is not in compliance with IAS 39.

BC26 After initial recognition, a financial liability that is classified as at fair value through profit or loss is measured at fair value under IAS 39, and other financial liabilities are measured at amortised cost. If the liability component of a compound financial instrument is classified as at fair value through profit or loss, an entity could recognise an immediate gain or loss after initial recognition if it applies a relative fair value method. This is contrary to IAS 32, paragraph 31, which states that no gain or loss arises from recognising the components of the instrument separately.

BC27 Under the *Framework*, and IASs 32 and 39, an equity instrument is defined as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Paragraph 67 of the *Framework*[*] further states that the amount at which equity is recognised in the balance sheet is dependent on the measurement of assets and liabilities.

BC28 The Board concluded that the alternatives in IAS 32 to measure on initial recognition the liability component of a compound financial instrument as a residual amount after separating the equity component or on the basis of a relative fair value method should be eliminated. Instead the liability component should be measured first (including the value of any embedded non-equity derivative features, such as an embedded call feature), and the residual amount assigned to the equity component.

BC29 The objective of this amendment is to make the requirements about the entity's separation of the liability and equity components of a single compound financial instrument consistent with the requirements about the initial measurement of a financial liability in IAS 39 and the definitions in IAS 32 and the *Framework* of an equity instrument as a residual interest.

[*] now paragraph 4.22 of the *Conceptual Framework*

BC30 This approach removes the need to estimate inputs to, and apply, complex option pricing models to measure the equity component of some compound financial instruments. The Board also noted that the absence of a prescribed approach led to a lack of comparability among entities applying IAS 32 and that it therefore was desirable to specify a single approach.

BC31 The Board noted that a requirement to use the with-and-without method, under which the liability component is determined first, is consistent with the proposals of the Joint Working Group of Standard Setters in its Draft Standard and Basis for Conclusions in *Financial Instruments and Similar Items,* published by IASC in December 2000 (see Draft Standard, paragraphs 74 and 75 and Application Supplement, paragraph 318).

Treasury shares (paragraphs 33, 34 and AG36)

BC32 The revised Standard incorporates the guidance in SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*. The acquisition and subsequent resale by an entity of its own equity instruments represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument, rather than a gain or loss to the entity.

Interest, dividends, losses and gains (paragraphs 35-41 and AG37)

Costs of an equity transaction (paragraphs 35 and 37-39)

BC33 The revised Standard incorporates the guidance in SIC-17 *Equity— Costs of an Equity Transaction*. Transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of the transaction to which they relate. Linking the equity transaction and costs of the transaction reflects in equity the total cost of the transaction.

Income tax consequences of distributions to holders of an equity instrument and of transaction costs of an equity transaction

BC33A In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board addressed perceived inconsistencies between IAS 12 *Income Taxes* and IAS 32 *Financial Instruments: Presentation* with regards to recognising the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction. Paragraph 52B of IAS 12 requires the recognition of the income tax consequences of dividends in profit or loss except when the circumstances described in paragraph 58(a) and (b) of IAS 12 arise. However, paragraph 35 of IAS 32 required the recognition of income tax relating to distributions to holders of an equity instrument in equity (prior to the amendment).

BC33B The Board noted that the intention of IAS 32 was to follow the requirements in IAS 12 for accounting for income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction. Consequently, the Board decided to add paragraph 35A to IAS 32 to clarify this intention.

BC33C The Board noted that this amendment is not intended to address the distinction between income tax consequences of dividends in accordance with paragraph 52B, and withholding tax for dividends in accordance with paragraph 65A, of IAS 12. In this respect, the Board observed that the income tax consequences of distributions to holders of an equity instrument are recognised in profit or loss in accordance with paragraph 52B of IAS 12. Consequently, to the extent that the distribution relates to income arising from a transaction that was originally recognised in profit or loss, the income tax on the distribution should be recognised in profit or loss. However, if the distribution relates to income or to a transaction that was originally recognised in other comprehensive income or equity, the entity should apply the exception in paragraph 58(a) of IAS 12, and recognise the income tax consequences of the distribution outside of profit or loss. The Board also observed that, in accordance with paragraph 65A, when an entity pays dividends to its shareholders the portion of the dividends paid or payable to taxation authorities as withholding tax is charged to equity as part of the dividends.

BC34 -BC48 [Deleted]

Summary of changes from the exposure draft

BC49 The main changes from the Exposure Draft's proposals are as follows:

(a) The Exposure Draft proposed to define a financial liability as a contractual obligation to deliver cash or another financial asset to another entity or to exchange financial instruments with another entity under conditions that are potentially unfavourable. The definition in the Standard has been expanded to include some contracts that will or may be settled in the entity's own equity instruments. The Standard's definition of a financial asset has been similarly expanded.

(b) The Exposure Draft proposed that a financial instrument that gives the holder the right to put it back to the entity for cash or another financial asset is a financial liability. The Standard retains this conclusion, but provides additional guidance and illustrative examples to assist entities that, as a result of this requirement, either have no equity as defined in IAS 32 or whose share capital is not equity as defined in IAS 32.

(c) The Standard retains and clarifies the proposal in the Exposure Draft that terms and conditions of a financial instrument may indirectly create an obligation.

(d) The Exposure Draft proposed to incorporate in IAS 32 the conclusion previously in SIC-5. This is that a financial instrument for which the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder is a financial liability. The Standard clarifies this conclusion by requiring contingent settlement provisions that apply only in the event of liquidation of an entity or are not genuine to be ignored.

(e) The Exposure Draft proposed that a derivative contract that contains an option as to how it is settled meets the definition of an equity instrument if the entity had all of the following: (i) an unconditional right and ability to settle the contract gross; (ii) an established practice of such settlement; and (iii) the intention to settle the contract gross. These conditions have not been carried forward into the Standard. Rather, a derivative with settlement options is classified as a financial asset or a financial liability unless all the settlement alternatives would result in equity classification.

(f) The Standard provides explicit guidance on accounting for the repurchase of a convertible instrument.

(g) The Standard provides explicit guidance on accounting for the amendment of the terms of a convertible instrument to induce early conversion.

(h) The Exposure Draft proposed that a financial instrument that is an equity instrument of a subsidiary should be eliminated on consolidation when held by the parent, or presented in the consolidated balance sheet within equity when not held by the parent (as a minority interest* separate from the equity of the parent). The Standard requires all terms and conditions agreed between members of the group and the holders of the instrument to be considered when determining if the group as a whole has an obligation that would give rise to a financial liability. To the extent there is such an obligation, the instrument (or component of the instrument that is subject to the obligation) is a financial liability in consolidated financial statements.

(i) [Deleted]

(j) [Deleted]

(k) In August 2005, the IASB issued IFRS 7 *Financial Instruments: Disclosures*. As a result, disclosures relating to financial instruments, if still relevant, were relocated to IFRS 7.

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

Amendments for some puttable instruments and some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

Amendment for puttable instruments

BC50 As discussed in paragraphs BC7 and BC8, puttable instruments meet the definition of a financial liability and the Board concluded that all such instruments should be classified as liabilities. However, constituents raised the following concerns about classifying such instruments as financial liabilities if they represent the residual claim to the net assets of the entity:

(a) On an ongoing basis, the liability is recognised at not less than the amount payable on demand. This can result in the entire market capitalisation of the entity being recognised as a liability depending on the basis for which the redemption value of the financial instrument is calculated.

(b) Changes in the carrying value of the liability are recognised in profit or loss. This results in counter-intuitive accounting (if the redemption value is linked to the performance of the entity) because:

(i) when an entity performs well, the present value of the settlement amount of the liabilities increases, and a loss is recognised.

(ii) when the entity performs poorly, the present value of the settlement amount of the liability decreases, and a gain is recognised.

(c) It is possible, again depending on the basis for which the redemption value is calculated, that the entity will report negative net assets because of unrecognised intangible assets and goodwill, and because the measurement of recognised assets and liabilities may not be at fair value.

(d) The issuing entity's statement of financial position portrays the entity as wholly, or mostly, debt funded.

(e) Distributions of profits to shareholders are recognised as expenses. Hence, it may appear that profit or loss is a function of the distribution policy, not performance.

Furthermore, constituents contended that additional disclosures and adapting the format of the statement of comprehensive income and statement of financial position did not resolve these concerns.

BC51 The Board agreed with constituents that many puttable instruments, despite meeting the definition of a financial liability, represent a residual interest in the net assets of the entity. The Board also agreed with constituents that additional disclosures and adapting the format of the entity's financial statements did not resolve the problem of the lack of relevance and understandability of that current accounting treatment. Therefore, the Board decided to amend IAS 32 to improve the financial reporting of these instruments.

BC52 The Board considered the following ways to improve the financial reporting of instruments that represent a residual interest in the net assets of the entity:

(a) to continue to classify these instruments as financial liabilities, but amend their measurement so that changes in their fair value would not be recognised;

(b) to amend IAS 32 to require separation of all puttable instruments into a put option and a host instrument; or

(c) to amend IAS 32 to provide a limited scope exception so that financial instruments puttable at fair value would be classified as equity, if specified conditions were met.

Amend the measurement of some puttable financial instruments so that changes in their fair value would not be recognised

BC53 The Board decided against this approach because:

(a) it is inconsistent with the principle in IAS 32 and IAS 39 that only equity instruments are not remeasured after their initial recognition;

(b) it retains the disadvantage that entities whose instruments are all puttable would have no equity instruments; and

(c) it introduces a new category of financial liabilities to IAS 39, and thus increases complexity.

Separate all puttable instruments into a put option and a host instrument

BC54 The Board concluded that conducting further research into an approach that splits a puttable share into an equity component and a written put option component (financial liability) would duplicate efforts of the Board's longer-term project on liabilities and equity. Consequently, the Board decided not to proceed with a project at this stage to determine whether a puttable share should be split into an equity component and a written put option component.

Classify as equity instruments puttable instruments that represent a residual interest in the entity

BC55 The Board decided to proceed with proposals to amend IAS 32 to require puttable financial instruments that represent a residual interest in the net assets of the entity to be classified as equity provided that specified conditions are met. The proposals represented a limited scope exception to the definition of a financial liability and a short-term solution, pending the outcome of the longer-term project on liabilities and equity. In June 2006 the Board published an exposure draft proposing that financial instruments puttable at fair value that meet specific criteria should be classified as equity.

BC56 In response to comments received from respondents to that exposure draft, the Board amended the criteria for identifying puttable instruments that represent a residual interest in the entity, to those included in paragraphs 16A and 16B. The Board decided on those conditions for the following reasons:

(a) to ensure that the puttable instruments, as a class, represent the residual interest in the net assets of the entity;

(b) to ensure that the proposed amendments are consistent with a limited scope exception to the definition of a financial liability; and

(c) to reduce structuring opportunities that might arise as a result of the amendments.

BC57 The Board decided that the instrument must entitle the holder to a pro rata share of the net assets on liquidation because the net assets on liquidation represent the ultimate residual interest of the entity.

BC58 The Board decided that the instrument must be in the class of instruments that is subordinate to all other classes of instruments on liquidation in order to represent the residual interest in the entity.

BC59 The Board decided that all instruments in the class that is subordinate to all other classes of instruments must have identical contractual terms and conditions. In order to ensure that the class of instruments as a whole is the residual class, the Board decided that no instrument holder in that class can have preferential terms or conditions in its position as an owner of the entity.

BC60 The Board decided that the puttable instruments should contain no contractual obligation to deliver a financial asset to another entity other than the put. That is because the amendments represent a limited scope exception to the definition of a financial liability and extending that exception to instruments that also contain other contractual obligations is not appropriate. Moreover, the Board concluded that if the puttable instrument contains another contractual obligation, that instrument may not represent the residual interest because the holder of the puttable instrument may have a claim to some of the net assets of the entity in preference to other instruments.

BC61 As well as requiring a direct link between the puttable instrument and the performance of the entity, the Board also decided that there should be no financial instrument or contract with a return that is more residual. The Board decided to require that there must be no other financial instrument or contract that has total cash flows based substantially on the performance of the entity and has the effect of significantly restricting or fixing the return to the puttable instrument holders. This criterion was included to ensure that the holders of the puttable instruments represent the residual interest in the net assets of the entity.

BC62 An instrument holder may enter into transactions with the issuing entity in a role other than that of an owner. The Board concluded that it is inappropriate to consider cash flows and contractual features related to the instrument holder in a non-owner role when evaluating whether a financial instrument has the features set out in paragraph 16A or paragraph 16C. That is because those cash flows and contractual features are separate and distinct from the cash flows and contractual features of the puttable financial instrument.

BC63 The Board also decided that contracts (such as warrants and other derivatives) to be settled by the issue of puttable financial instruments should be precluded from equity classification. That is because the Board noted that the amendments represent a limited scope exception to the definition of a financial liability and extending that exception to such contracts is not appropriate.

Amendment for obligations to deliver to another party a pro rata share of the net assets of the entity only on liquidation

BC64 Issues similar to those raised by constituents relating to classification of puttable financial instruments apply to some financial instruments that create an obligation only on liquidation of the entity.

BC65 In the exposure draft published in June 2006, the Board proposed to exclude from the definition of a financial liability a contractual obligation that entitles the holder to a pro rata share of the net assets of the entity only on liquidation of the entity. The liquidation of the entity may be:

(a) certain to occur and outside the control of the entity (limited life entities); or

(b) uncertain to occur but at the option of the holder (for example, some partnership interests).

BC66 Respondents to that exposure draft were generally supportive of the proposed amendment.

BC67 The Board decided that an exception to the definition of a financial liability should be made for instruments that entitle the holder to a pro rata share of the net assets of an entity only on liquidation if particular requirements are met. Many of those requirements, and the reasons for them, are similar to those for puttable financial instruments. The differences between the requirements are as follows:

(a) there is no requirement that there be no other contractual obligations;

(b) there is no requirement to consider the expected total cash flows throughout the life of the instrument;

(c) the only feature that must be identical among the instruments in the class is the obligation for the issuing entity to deliver to the holder a pro rata share of its net assets on liquidation.

The reason for the differences is the timing of settlement of the obligation. The life of the financial instrument is the same as the life of the issuing entity; the extinguishment of the obligation can occur only at liquidation. Therefore, the Board concluded that it was appropriate to focus only on the obligations that exist at liquidation. The instrument must be subordinate to all other classes of instruments and represent the residual interests only at that point in time. However, if the instrument contains other contractual obligations, those obligations may need to be accounted for separately in accordance with the requirements of IAS 32.

Non-controlling interests

BC68 The Board decided that puttable financial instruments or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation should be classified as equity in the separate financial statements of the issuer if they represent the residual class of instruments (and all the relevant requirements are met). The Board decided that such instruments were not the residual interest in the consolidated financial statements and therefore that non-controlling interests that contain an obligation to transfer a financial asset to another entity should be classified as a financial liability in the consolidated financial statements.

Analysis of costs and benefits

BC69 The Board acknowledged that the amendments made in February 2008 are not consistent with the definition of a liability in the *Framework*, or with the underlying principle of IAS 32, which is based on that definition. Consequently, those amendments added complexity to IAS 32 and introduced the need for detailed rules. However, the Board also noted that IAS 32 contains other exceptions to its principle (and the definition of a liability in the *Framework*) that require instruments to be classified as liabilities that otherwise would be treated as equity. Those exceptions highlight the need for a comprehensive reconsideration of the distinctions between liabilities and equity, which the Board is undertaking in its long-term project.

BC70 In the interim, the Board concluded that classifying as equity the instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D would improve the comparability of information provided to the users of financial statements. That is because financial instruments that are largely equivalent to ordinary shares would be consistently classified across different entity structures (eg some partnerships, limited life entities and co-operatives). The specified instruments differ from ordinary shares in one respect; that difference is the obligation to deliver cash (or another financial asset). However, the Board concluded that the other characteristics of the specified instruments are sufficiently similar to ordinary shares for the instruments to be classified as equity. Consequently, the Board concluded that the amendments will result in financial reporting that is more understandable and relevant to the users of financial statements.

BC71 Furthermore, in developing the amendments, the Board considered the costs to entities of obtaining information necessary to determine the required classification. The Board believes that the costs of obtaining any new information would be slight because all of the necessary information should be readily available.

BC72 The Board also acknowledged that one of the costs and risks of introducing exceptions to the definition of a financial liability is the structuring opportunities that may result. The Board concluded that financial structuring opportunities are minimised by the detailed criteria required for equity classification and the related disclosures.

BC73 Consequently, the Board believed that the benefits of the amendments outweigh the costs.

BC74 The Board took the view that, in most cases, entities should be able to apply the amendments retrospectively. The Board noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides relief when it is impracticable to apply a change in accounting policy retrospectively as a result of a new requirement. Furthermore, the Board took the view that the costs outweighed the benefits of separating a compound financial instrument with an obligation to deliver a pro rata share of the net assets of the entity only on liquidation when the liability component is no longer outstanding on the date of initial application. Hence, there is no requirement on transition to separate such compound instruments.

Dissenting opinions

Dissent of James J Leisenring from the issue of IAS 32 in December 2003

DO1 Mr Leisenring dissents from IAS 32 because, in his view, the conclusions about the accounting for forward purchase contracts and written put options on an issuer's equity instruments that require physical settlement in exchange for cash are inappropriate. IAS 32 requires a forward purchase contract to be recognised as though the future transaction had already occurred. Similarly it requires a written put option to be accounted for as though the option had already been exercised. Both of these contracts result in combining the separate forward contract and the written put option with outstanding shares to create a synthetic liability.

DO2 Recording a liability for the present value of the fixed forward price as a result of a forward contract is inconsistent with the accounting for other forward contracts. Recording a liability for the present value of the strike price of an option results in recording a liability that is inconsistent with the *Framework*[*] as there is no present obligation for the strike price. In both instances the shares considered to be subject to the contracts are outstanding, have the same rights as any other shares and should be accounted for as outstanding. The forward and option contracts meet the definition of a derivative and should be accounted for as derivatives rather than create an exception to the accounting required by IAS 39. Similarly, if the redemption feature is embedded in the equity instrument (for example, a redeemable preference share) rather than being a free-standing derivative contract, the redemption feature should be accounted for as a derivative.

DO3 Mr Leisenring also objects to the conclusion that a purchased put or call option on a fixed number of an issuer's equity instruments is not an asset. The rights created by these contracts meet the definition of an asset and should be accounted for as assets and not as a reduction in equity. These contracts also meet the definition of derivatives that should be accounted for as such consistently with IAS 39.

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

Dissent of Mary E Barth and Robert P Garnett from the issue of *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1) in February 2008

DO1 Professor Barth and Mr Garnett voted against the publication of *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1 *Presentation of Financial Statements*).The reasons for their dissent are set out below.

DO2 These Board members believe that the decision to permit entities to classify as equity some puttable financial instruments and some financial instruments that entitle the holder to a pro rata share of the net assets of the entity only on liquidation is inconsistent with the *Framework*[*]. The contractual provisions attached to those instruments give the holders the right to put the instruments to the entity and demand cash. The *Framework's* definition of a liability is that it is a present obligation of the entity arising from a past event, the settlement of which is expected to result in an outflow of resources of the entity. Thus, financial instruments within the scope of the amendments clearly meet the definition of a liability in the *Framework*.

DO3 These Board members do not agree with the Board that an exception to the *Framework* is justified in this situation. First, the Board has an active project on the *Framework*, which will revisit the definition of a liability. Although these Board members agree that standards projects can precede decisions in the *Framework* project, the discussions to date in the *Framework* project do not make it clear that the Board will modify the existing elements definitions in such a way that these instruments would be equity. Second, the amendments would require disclosure of the expected cash outflow on redemption or repurchase of puttable instruments classified as equity. These disclosures are similar to those for financial liabilities; existing standards do not require similar disclosure for equity instruments. The Board's decision to require these disclosures reveals its implicit view these instruments are, in fact, liabilities. Yet, the *Framework* is clear that disclosure is not a substitute for recognition. Third, these Board members see no cost-benefit or practical reasons for making this exception. The amendments require the same or similar information to be obtained and disclosed as would be the case if these obligations were classified as liabilities. Existing standards offer presentation alternatives for entities that have no equity under the *Framework*'s definitions.

DO4 These Board members also do not agree with the Board that there are benefits to issuing these amendments. First, paragraph BC70 in the Basis for Conclusions states that the amendments will result in more relevant and understandable financial reporting. However, as noted above, these Board members do not believe that presenting as equity items that meet the *Framework*'s definition of a liability results in relevant information. Also as noted above, existing standards offer presentation alternatives that result in understandable financial reporting.

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

DO5 Second, paragraph BC70 states that the amendments would increase comparability by requiring more consistent classification of financial instruments that are largely equivalent to ordinary shares. These Board members believe that the amendments decrease comparability. These instruments are not comparable to ordinary shares because these instruments oblige the entity to transfer its economic resources; ordinary shares do not. Also, puttable instruments and instruments that entitle the holder to a pro rata share of the net assets of the entity only on liquidation will be classified as equity by some entities and as liabilities by other entities, depending on whether the other criteria specified in the amendments are met. Thus, these amendments account similarly for economically different instruments, which decreases comparability.

DO6 Finally, these Board members do not believe that the amendments are based on a clear principle. Rather, they comprise several paragraphs of detailed rules crafted to achieve a desired accounting result. Although the Board attempted to craft these rules to minimise structuring opportunities, the lack of a clear principle leaves open the possibility that economically similar situations will be accounted for differently and economically different situations will be accounted for similarly. Both of these outcomes also result in lack of comparability.

Dissent of James J Leisenring and John T Smith from the issue of *Classification of Rights Issues*

DO1 Messrs Leisenring and Smith dissent from the amendment *Classification of Rights Issues* for the reasons set out below.

DO2 Mr Smith agrees with the concept of accounting for a rights issue as equity in specified circumstances and supports both the IFRIC recommendation and staff recommendation in July 2009 that the Board make 'an extremely narrow amendment' to IAS 32 to deal with this issue. However, he dissents because he believes the change is not extremely narrow and will provide a means for an entity to use its equity instruments as a way to engage in speculative foreign currency transactions and structure them as equity transactions, a concern identified by the Board in the Basis for Conclusions on IAS 32.

DO3 In their comment letters on the exposure draft, some respondents expressed concerns that the wording of the amendment was too open-ended and could lead to structuring risks. Mr Smith believes that these concerns are well-founded because there is no limitation on what qualifies as a class of equity. Without some limitation, an entity could, for example, establish a foreign currency trading subsidiary, issue shares to a non-controlling interest and deem the shares to be a class of equity in the consolidated group.

DO4 The staff acknowledged the concerns expressed in comment letters that a new class of equity could be created for the purpose of obtaining a desired accounting treatment. However, the Board decided not to attempt to limit such structuring opportunities. The Board was concerned that a requirement that a pro rata offer of rights must be made to all existing owners (rather than only all existing owners of a particular class) of equity instruments would mean that the amendment would not be applicable to most of the transactions to which the Board intended the amendment to apply.

DO5 Instead of trying to narrow the amendment, the Board simply acknowledged that under the amendment, 'You could set up a new class of shares today and one minute later issue shares to that class and ... speculate in foreign currency without it going through the income statement.' Mr Smith believes the Board should have explored other alternatives. Mr Smith believes that the Board should have sought solutions that could in fact provide a means of narrowing the amendment to limit structuring while accommodating appropriate transactions.

DO6 Mr Smith believes that structuring opportunities could be curtailed significantly if some limitations were placed on the type of class of equity instruments that qualify for the exemption. There are a number of factors or indicators that could have been incorporated into the amendment that would limit the exception. For example, the amendment could have specified that non-controlling interests do not constitute a class. The amendment could have further required that qualification for the exemption is limited to those classes of equity instruments in which (a) ownership in the class is diverse or (b) the class is registered on an exchange and shares are exchanged in the marketplace or (c) shares in that class when issued were offered to the public at large and sold in more than one jurisdiction and there was no agreement to subsequently offer rights to shares of the entity; and the amount of capital provided by the class is substantial relative to the other classes of equity. Clearly, some combination of these and other alternatives could have been used to limit structuring opportunities. Mr Smith believes that a better solution could have been found and without introducing some limits around the type of class of equity instruments that qualify, the Board did not produce an extremely narrow amendment.

DO7 Mr Leisenring agrees that when an entity issues rights to acquire its own equity instruments those rights should be classified as equity. However, he does not accept that the issue must be pro rata to all existing shareholders of a class of non-derivative equity instruments. He does not accept that whether or not the offer is pro rata is relevant to determining if the transaction meets the definition of a liability.

DO8 Paragraph BC4J suggests that the Board limited its conclusion to those transactions issued on a pro rata basis because of concerns about structuring risks. If that is of concern the suggestions contained in Mr Smith's dissent would be much more effective and desirable than introducing a precedent that transactions such as this rights offering must simply be pro rata to be considered a transaction with owners as owners.

DO9 Mr Leisenring would have preferred to conclude that a right granted for a fixed amount of a currency was a 'fixed for fixed' exchange rather than create additional conditions to the determination of a liability.

Appendix

Amendments to Basis for Conclusions on IAS 32 *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2014

The following sets out amendments required for this Basis for Conclusions resulting from amendments to IAS 32 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

After paragraph BC74, headings and paragraphs BC75–BC120 are added.

Amendments to the application guidance for offsetting financial assets and financial liabilities

Background

BC75 Following requests from users of financial statements and recommendations from the Financial Stability Board, in June 2010 the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), added a project to their respective agendas to improve, and potentially achieve convergence of, the requirements for offsetting financial assets and financial liabilities. The boards made this decision because the differences in their requirements for offsetting financial assets and financial liabilities cause significant differences between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP. This is particularly so for entities that have large amounts of derivative activities.

BC76 Consequently, in January 2011 the Board published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. The proposals in the exposure draft would have established a common approach with the FASB. The exposure draft also proposed disclosures about financial assets and financial liabilities that are subject to set-off rights and related arrangements (such as collateral agreements), and the effect of those rights and arrangements on an entity's financial position.

BC77 As a result of the feedback received on the exposure draft, the IASB and the FASB decided to maintain their current offsetting models. However, the boards noted that requiring common disclosures of gross and net information would be helpful for users of financial statements. Accordingly, the boards agreed on common disclosure requirements by amending and finalising the disclosures that were initially proposed in the exposure draft. The amendments *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) were issued in December 2011.

BC78 In addition, the IASB decided to add application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This included clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.

Requirements for offsetting financial assets and financial liabilities

Criterion that an entity 'currently has a legally enforceable right to set off the recognised amounts' (paragraph 42(a))

BC79 To meet the criterion in paragraph 42(a) of IAS 32, an entity must currently have a legally enforceable right to set off the recognised amounts. However, IAS 32 did not previously provide guidance on what was meant by 'currently has a legally enforceable right to set off'. Feedback from the exposure draft revealed inconsistencies in the application of this criterion by IFRS preparers. Consequently, the Board decided to include application guidance in IAS 32 (paragraphs AG38A–AG38D) to clarify the meaning of this criterion.

BC80 The Board believes that the net amounts of financial assets and financial liabilities presented in the statement of financial position should represent an entity's exposure in the normal course of business and its exposure if one of the parties will not or cannot perform under the terms of the contract. The Board therefore clarified in paragraph AG38B that to meet the criterion in paragraph 42(a) of IAS 32 a right of set-off is required to be legally enforceable in the normal course of business, the event of default and the event of insolvency or bankruptcy of the entity and all of the counterparties. The right must exist for all counterparties so that if an event occurs for one of the counterparties, including the entity, the other counterparty or parties will be able to enforce the right of set-off against the party that has defaulted or gone insolvent or bankrupt.

BC81 If a right of set-off cannot be enforced in the event of default and in the event of insolvency or bankruptcy, then offsetting would not reflect the economic substance of the entity's rights and obligations and would therefore not meet the objective of offsetting in paragraph 43 of IAS 32. The Board uses the term 'in the event of default and in the event of insolvency or bankruptcy' to describe scenarios where an entity will not or cannot perform under the contract.

BC82 The use of the word 'currently' in paragraph 42(a) of IAS 32 means that the right of set-off cannot be contingent on a future event. If a right of set-off were contingent or conditional on a future event an entity would not currently have a (legally enforceable) right of set-off. The right of set-off would not exist until the contingency occurred, if at all.

BC83 In addition, the Board believes that the passage of time or uncertainties in amounts to be paid do not preclude an entity from currently having a (legally enforceable) right of set-off. The fact that the payments subject to a right of set-off will only arise at a future date is not in itself a condition or a form of contingency that prevents offsetting in accordance with paragraph 42(a) of IAS 32.

BC84 However, if the right of set-off is not exercisable during a period when amounts are due and payable, then the entity does not meet the offsetting criterion as it has no right to set off those payments. Similarly, a right of set-off that could disappear or that would no longer be enforceable after a future event that could take place in the normal course of business or in the event of default, or in the event of insolvency or bankruptcy, such as a ratings downgrade, would not meet the currently (legally enforceable) criterion in paragraph 42(a) of IAS 32.

BC85 The application of the word 'currently' in paragraph 42(a) of IAS 32 was not a source of inconsistency in practice but rather a question that arose as a result of the wording in the exposure draft. Consequently, the Board decided that further application guidance was only required for the legal enforceability part of the criterion.

BC86 In developing the proposals in the exposure draft, the Board concluded that the net amount represents the entity's right or obligation if (a) the entity has the ability to insist on net settlement or to enforce net settlement in all situations (ie the exercise of that right is not contingent on a future event), (b) that ability is assured, and (c) the entity intends to receive or pay a single net amount, or to realise the asset and settle the liability simultaneously.

BC87 Some respondents were concerned that the terms 'in all situations' and 'the ability is assured' as referred to in paragraph BC86 create a higher hurdle than IAS 32 today. The Board however believes that the conclusions in the exposure draft are consistent with the offsetting criteria and principle in IAS 32, specifically paragraphs 42, 43, 46 and 47. In addition, the application guidance in paragraph AG38B of IAS 32 addresses respondents' concerns by clarifying the circumstances in which an entity should be able to net (ie what 'in all situations' means), and by requiring legal enforceability in such circumstances, a term commonly used in applying IAS 32 today.

Applicability to all counterparties

BC88 The proposals in the exposure draft required that the right of set-off be legally enforceable in the event of default and in the event of insolvency or bankruptcy of 'one of the counterparties' (including the entity itself). There were differing views as to whether the requirement that the right of set-off must be enforceable in the event of the entity's default and/or insolvency or bankruptcy changed the criteria in IAS 32 today.

BC89 Some respondents disagreed that the right of set-off must be enforceable in the events of default and insolvency or bankruptcy of the entity. Although consideration is given to enforceability today to achieve offsetting in accordance with IAS 32, some have only focused on the effects of the insolvency or bankruptcy of the counterparty. These respondents questioned whether legal opinions as to enforceability in the event of their own insolvency or bankruptcy could be obtained and considered this to be a change in practice from IAS 32 that could increase costs and the burden for preparers. They also believed that such a requirement would be inconsistent with the going concern basis of preparation for financial statements.

BC90 Other respondents, however, agreed that, to represent the entity's net exposure at all times, the right of set-off must be enforceable in the insolvency or bankruptcy of all of the counterparties to the contract.

BC91 The Board believes that limiting the enforcement of the right of set-off to the event of default and the event of insolvency or bankruptcy of the counterparty (and not the entity itself) is not consistent with the principle and objective of offsetting in IAS 32.

BC92 If a right of set-off cannot also be enforced in the event of default and in the event of insolvency or bankruptcy of the entity, then offsetting would not reflect the economic substance of the entity's rights and obligations or the financial position of the entity (ie offsetting would not reflect an entity's expected future cash flows from settling two or more separate financial instruments in accordance with paragraph 43 of IAS 32) and would therefore not meet the objective of offsetting in IAS 32.

BC93 Consequently, the Board decided to clarify that, to meet the offsetting criterion in paragraph 42(a) of IAS 32, a right of set-off must be enforceable in the event of default and in the event of insolvency or bankruptcy of both the entity and its counterparties (paragraphs AG38A and AG38B of IAS 32).

Criterion that an entity 'intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously' (paragraph 42(b))

BC94 In the exposure draft the boards noted that offsetting financial assets and financial liabilities is appropriate and reflects the financial position of an entity only if the entity has, in effect, a right to, or an obligation for, only the net amount (ie the entity has, in effect, a single net financial asset or net financial liability). The amount resulting from offsetting must also reflect the entity's expected future cash flows from settling two or more separate financial instruments. This is consistent with the principle in paragraph 43 of IAS 32.

BC95 When developing that principle the boards understood that entities may currently have a legally enforceable right and desire to settle net, but may not have the operational capabilities to effect net settlement. The gross positions would be settled at the same moment such that the outcome would not be distinguishable from net settlement. As a result the boards included simultaneous settlement as a practical exception to net settlement. Simultaneous settlement was intended to capture payments that are essentially equivalent to actual net settlement. The proposals in the exposure draft also defined simultaneous settlement as settlement 'at the same moment'.

BC96 Simultaneous settlement as 'at the same moment' is already a concept in paragraph 48 of IAS 32 that enables an entity to meet the criterion in paragraph 42(b) of IAS 32. However, feedback received during outreach indicated that there was diversity in practice related to the interpretation of 'simultaneous settlement' in IAS 32. Many preparers and accounting firms have interpreted paragraph 48 of IAS 32 to mean that settlement through a clearing house always meets the simultaneous settlement criterion even if not occurring at the same moment.

BC97 Respondents also noted that settlement of two positions by exchange of gross cash flows at exactly the same moment (simultaneously) rarely occurs in practice today. They argued that 'simultaneous' is not operational and ignores settlement systems that are established to achieve what is economically considered to be net exposure.

BC98 Some preparers also indicated that settlement through some gross settlement mechanisms, though not simultaneous, effectively results in the same exposure as in net settlement or settlement at the same moment and are currently considered to meet the requirements in IAS 32, without actually taking place 'at the same moment'. For particular settlement mechanisms, once the settlement process commences, the entity is not exposed to credit or liquidity risk over and above the net amount and therefore the process is equivalent to net settlement.

BC99 Paragraph 48 of IAS 32 states that simultaneous settlement results in 'no exposure to credit or liquidity risk'. In its redeliberations the Board considered gross settlement mechanisms with features that both (i) eliminate credit and liquidity risk; and (ii) process receivables and payables in a single settlement process. The Board agreed that gross settlement systems with such features are effectively equivalent to net settlement.

BC100 To clarify the application of the IAS 32 offsetting criteria and to reduce diversity in practice, the Board therefore clarified the principle behind net settlement and included an example of a gross settlement system with characteristics that would satisfy the IAS 32 criterion for net settlement in paragraph AG38F of IAS 32.

BC101 However, the Board decided not to refer specifically to clearing houses or central counterparties when describing systems that may be treated as equivalent to net settlement for the purposes of the set-off criterion. Systems that meet the principle in paragraph AG38F of IAS 32 may be referred to by different names in different jurisdictions. Referring to specific types of settlement systems may exclude other systems that are also considered equivalent to net settlement. In addition, the Board did not want to imply that settlement through specific systems would always meet the net settlement criterion. Entities must determine whether a system meets the principle in paragraph AG38F of IAS 32 by determining whether or not the system eliminates or results in insignificant credit and liquidity risk and processes receivables and payables in the same settlement process or cycle.

Offsetting collateral amounts

BC102 The proposals in the exposure draft specifically prohibited offsetting assets pledged as collateral (or the right to reclaim the collateral pledged) or the obligation to return collateral sold with the associated financial assets and financial liabilities. A number of respondents disagreed with the proposed treatment of collateral and noted that the proposed prohibition was more restrictive than the offsetting criteria in paragraph 42 of IAS 32.

BC103 The offsetting criteria in IAS 32 do not give special consideration to items referred to as 'collateral'. The Board confirmed that a recognised financial instrument referred to as collateral should be set off against the related financial asset or financial liability in the statement of financial position if, and only if, it meets the offsetting criteria in paragraph 42 of IAS 32. The Board also noted that if an entity can be required to return or receive back collateral, the entity would not currently have a legally enforceable right of set-off in all of the following circumstances: in the normal course of business, the event of default and the event of insolvency or bankruptcy of one of the counterparties.

BC104 Because no particular practice concerns or inconsistencies were brought to the Board's attention related to the treatment of collateral in accordance with the offsetting criteria in IAS 32, and as the concerns that arose originated from the proposals in the exposure draft, the Board did not consider it necessary to add application guidance for the treatment of collateral.

Unit of account

BC105 Neither IAS 32 nor the exposure draft specifies the unit of account to which the offsetting requirements should be applied. During the outreach performed on the exposure draft, it became apparent that there was diversity in practice regarding the unit of account that was used for offsetting in accordance with IAS 32.

BC106 Entities in some industries (for example, energy producers and traders) apply the offsetting criteria to identifiable cash flows. Other entities apply the offsetting criteria to entire financial assets and financial liabilities. For those entities (for example, financial institutions), applying the offsetting criteria to individual identifiable cash flows (portions of financial assets and financial liabilities) within contracts would be impractical and burdensome, even though requiring application of the offsetting criteria to entire financial instruments results in less offsetting in the statement of financial position.

BC107 The Board acknowledged that the focus of the offsetting model is the entity's net exposure and expected future cash flows from settling the related financial instruments.

BC108 The Board also noted that some of the entities for whom the offsetting requirements are most relevant are those that would have the most significant operational challenges with applying the model to individual cash flows (such as financial institutions with large derivative activities). This is important to consider because IAS 32 requires offsetting if the offsetting criteria are met.

BC109 On the other hand, if the application of the offsetting criteria to individual cash flows was prohibited, entities in some industries (for example, energy producers and traders) that apply the criteria in IAS 32 to individual cash flows of financial instruments, and achieve set-off on that basis today, would no longer be permitted to do so.

BC110 The Board considered clarifying the application guidance in IAS 32 to indicate that offsetting should apply to individual cash flows of financial instruments. However, if it made such clarification, the Board felt that it would be necessary to consider an exemption from this requirement on the basis of operational complexity. This would result in the offsetting requirements still being applied differently between entities.

BC111 Although different interpretations of the unit of account are applied today, the Board concluded that this does not result in inappropriate application of the offsetting criteria. The benefits of amending IAS 32 would not outweigh the costs for preparers and therefore the Board decided not to amend the application guidance to IAS 32 on this subject.

Cost-benefit considerations

BC112 Before issuing an IFRS or an amendment to an IFRS, the Board seeks to ensure that it will meet a significant need and that the overall benefits of the resulting information will justify the costs of providing it. The Board issued *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32) to eliminate inconsistencies in the application of the offsetting criteria in paragraph 42 of IAS 32 by clarifying the meaning of ‘currently has a legally enforceable right of set-off’ and that some gross settlement systems may be considered equivalent to net settlement.

BC113 Some respondents were concerned that requiring a right of set-off to be enforceable in the event of default and in the event of insolvency or bankruptcy of the entity would increase the cost of applying the offsetting criteria in IAS 32, if, for example, they needed to obtain additional legal opinions on enforceability. However, the Board noted that without this clarification the offsetting criteria would continue to be applied inconsistently, and the resulting offsetting would be inconsistent with the offsetting objective in IAS 32. This would also reduce comparability for users of financial statements. Consequently, the Board concluded that the benefit of clarifying this criterion outweighed the cost to preparers of applying these amendments.

BC114 During redeliberations the Board also considered feedback received on the proposals in the exposure draft related to the treatment of collateral and unit of account. However, as described in greater detail in other sections of this Basis for Conclusions, the Board did not consider it necessary to add application guidance for the treatment of these items.

BC115 The amendments to the IAS 32 application guidance (paragraphs AG38A–AG38F of IAS 32) are intended to clarify the Board’s objective for the offsetting criteria and therefore eliminate inconsistencies noted in applying paragraph 42 of IAS 32.

BC116 Based on the considerations described in the Basis for Conclusions of these amendments, and summarised in paragraphs BC112–BC115, the Board concluded that the benefits of *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32) outweigh the costs to preparers of applying those amendments.

Transition and effective date

BC117 During redeliberations, the Board originally decided to require retrospective application of the application guidance in paragraphs AG38A–AG38F of IAS 32 for annual periods beginning on or after 1 January 2013. The Board did not expect significant changes in practice as a result of the clarifications made to the application guidance and hence aligned the effective date and transition of these amendments with that of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), issued in December 2011.

BC118 However, the Board received additional feedback from some preparers that the clarifications to the application guidance could change their practice. These preparers indicated that they needed more time to evaluate the effects of the amendments. They indicated that it would be difficult for them to make this assessment in time to allow application of the amendments to the application guidance for the first comparative reporting period.

BC119 Preparers therefore requested that the Board consider aligning the effective date of the amendments with the revised effective date of IFRS 9 *Financial Instruments* (1 January 2015), with earlier application allowed. This would give them sufficient time to determine if there would be any changes to their financial statements.

BC120 The Board believed that the amendments to the IAS 32 application guidance should be effective as soon as possible to ensure comparability of financial statements prepared in accordance with IFRSs. In addition, the Board did not consider that the effective date needed to be aligned with that of IFRS 9. However, the Board also understood the concerns of preparers. The Board therefore decided to require the amendments to the IAS 32 application guidance to be effective for periods beginning 1 January 2014 with earlier application permitted. This would provide a balance between the time needed to implement the amendments with the need for consistent application of the IAS 32 offsetting requirements.

HKAS 33
Revised ~~March 2010~~May 2014

Hong Kong Accounting Standard 33

Earnings per Share

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

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Hong Kong Accounting Standard 33
Earnings per Share

Objective

1 The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share, so as to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity. Even though earnings per share data have limitations because of the different accounting policies that may be used for determining 'earnings', a consistently determined denominator enhances financial reporting. The focus of this Standard is on the denominator of the earnings per share calculation.

Scope

2 This Standard shall apply to:

(a) the separate or individual financial statements of an entity:

(i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or

(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market; and

(b) the consolidated financial statements of a group with a parent:

(i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or

(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market.

3 An entity that discloses earnings per share shall calculate and disclose earnings per share in accordance with this Standard.

4 When an entity presents both consolidated financial statements and separate financial statements prepared in accordance with <u>HKFRS 10 *Consolidated Financial Statements* and</u> HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements* <u>respectively</u>, the disclosures required by this Standard need be presented only on the basis of the consolidated information. An entity that chooses to disclose earnings per share based on its separate financial statements shall present such earnings per share information only in its statement of comprehensive income. An entity shall not present such earnings per share

information in the consolidated financial statements.

4A **If an entity presents ~~the components~~ items of profit or loss in a separate income statement as described in paragraph ~~81~~10A of HKAS 1 *Presentation of Financial Statements* (as ~~revised~~ amended in ~~2007~~2011), it presents earnings per share only in that separate statement.**

Definitions

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

Antidilution **is an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.**

A *contingent share agreement* **is an agreement to issue shares that is dependent on the satisfaction of specified conditions.**

Contingently issuable ordinary shares **are ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions in a contingent share agreement.**

Dilution **is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.**

Options, warrants and their equivalents **are financial instruments that give the holder the right to purchase ordinary shares.**

An *ordinary share* **is an equity instrument that is subordinate to all other classes of equity instruments.**

A *potential ordinary share* **is a financial instrument or other contract that may entitle its holder to ordinary shares.**

Put options **on ordinary shares are contracts that give the holder the right to sell ordinary shares at a specified price for a given period.**

6 Ordinary shares participate in profit for the period only after other types of shares such as preference shares have participated. An entity may have more than one class of ordinary shares. Ordinary shares of the same class have the same rights to receive dividends.

7 Examples of potential ordinary shares are:

(a) financial liabilities or equity instruments, including preference shares, that are convertible into ordinary shares;

(b) options and warrants;

(c) shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.

8 Terms defined in HKAS 32 *Financial Instruments: Presentation* are used in this Standard with the meanings specified in paragraph 11 of HKAS 32, unless otherwise noted. HKAS 32 defines financial instrument, financial asset, financial liability~~,~~ and equity instrument~~, and fair value~~, and provides guidance on applying those definitions. HKFRS 13 *Fair Value Measurement* defines fair value and sets out requirements for applying that definition.

Measurement

Basic earnings per share

9 An entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

10 Basic earnings per share shall be calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.

11 The objective of basic earnings per share information is to provide a measure of the interests of each ordinary share of a parent entity in the performance of the entity over the reporting period.

Earnings

12 For the purpose of calculating basic earnings per share, the amounts attributable to ordinary equity holders of the parent entity in respect of:

(a) profit or loss from continuing operations attributable to the parent entity; and

(b) profit or loss attributable to the parent entity

shall be the amounts in (a) and (b)adjusted for the after-tax amounts of preference dividends, differences arising on the settlement of preference shares, and other similar effects of preference shares classified as equity.

13 All items of income and expense attributable to ordinary equity holders of the parent entity that are recognised in a period, including tax expense and dividends on preference shares classified as liabilities are included in the determination of profit or loss for the period attributable to ordinary equity holders of the parent entity (see HKAS 1).

37 Dilutive potential ordinary shares shall be determined independently for each period presented. The number of dilutive potential ordinary shares included in the year-to-date period is not a weighted average of the dilutive potential ordinary shares included in each interim computation.

38 Potential ordinary shares are weighted for the period they are outstanding. Potential ordinary shares that are cancelled or allowed to lapse during the period are included in the calculation of diluted earnings per share only for the portion of the period during which they are outstanding. Potential ordinary shares that are converted into ordinary shares during the period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the resulting ordinary shares are included in both basic and diluted earnings per share.

39 The number of ordinary shares that would be issued on conversion of dilutive potential ordinary shares is determined from the terms of the potential ordinary shares. When more than one basis of conversion exists, the calculation assumes the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential ordinary shares.

40 A subsidiary, joint venture or associate may issue to parties other than the parent~~,~~ ~~venturer~~ or investors with joint control of, or significant influence over, the investee potential ordinary shares that are convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent~~,~~ or investors with joint control of, or significant influence ~~venturer or investor~~ (the reporting entity) over, the investee. If these potential ordinary shares of the subsidiary, joint venture or associate have a dilutive effect on the basic earnings per share of the reporting entity, they are included in the calculation of diluted earnings per share.

Dilutive potential ordinary shares

41 Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations.

42 An entity uses profit or loss from continuing operations attributable to the parent entity as the control number to establish whether potential ordinary shares are dilutive or antidilutive. Profit or loss from continuing operations attributable to the parent entity is adjusted in accordance with paragraph 12 and excludes items relating to discontinued operations.

43 Potential ordinary shares are antidilutive when their conversion to ordinary shares would increase earnings per share or decrease loss per share from continuing operations. The calculation of diluted earnings per share does not assume conversion, exercise, or other issue of potential ordinary shares that would have an antidilutive effect on earnings per share.

44 In determining whether potential ordinary shares are dilutive or antidilutive, each issue or series of potential ordinary shares is considered separately rather than in aggregate. The sequence in which potential ordinary shares are considered may affect whether they are dilutive. Therefore, to maximise the dilution of basic earnings per share, each issue or series of potential ordinary shares is considered in sequence from the most dilutive to the least dilutive, ie dilutive potential ordinary shares with the lowest 'earnings per incremental share' are included in the diluted earnings per share calculation before those with a higher earnings per incremental share. Options and warrants are generally included first because they do not affect the numerator of the calculation.

Options, warrants and their equivalents

45 For the purpose of calculating diluted earnings per share, an entity shall assume the exercise of dilutive options and warrants of the entity. The assumed proceeds from these instruments shall be regarded as having been received from the issue of ordinary shares at the average market price of ordinary shares during the period. The difference between the number of ordinary shares issued and the number of ordinary shares that would have been issued at the average market price of ordinary shares during the period shall be treated as an issue of ordinary shares for no consideration.

46 Options and warrants are dilutive when they would result in the issue of ordinary shares for less than the average market price of ordinary shares during the period. The amount of the dilution is the average market price of ordinary shares during the period minus the issue price. Therefore, to calculate diluted earnings per share, potential ordinary shares are treated as consisting of both the following:

(a) a contract to issue a certain number of the ordinary shares at their average market price during the period. Such ordinary shares are assumed to be fairly priced and to be neither dilutive nor antidilutive. They are ignored in the calculation of diluted earnings per share.

(b) a contract to issue the remaining ordinary shares for no consideration. Such ordinary shares generate no proceeds and have no effect on profit or loss attributable to ordinary shares outstanding. Therefore, such shares are dilutive and are added to the number of ordinary shares outstanding in the calculation of diluted earnings per share.

47 Options and warrants have a dilutive effect only when the average market price of ordinary shares during the period exceeds the exercise price of the options or warrants (ie they are 'in the money'). Previously reported earnings per share are not retroactively adjusted to reflect changes in prices of ordinary shares.

47A For share options and other share-based payment arrangements to which HKFRS 2 *Share-based Payment* applies, the issue price referred to in paragraph 46 and the exercise price referred to in paragraph 47 shall include the fair value (measured in accordance with HKFRS 2) of any goods or services to be supplied to the entity in the future under the share option or other share-based payment arrangement.

Retrospective adjustments

64 **If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively. If these changes occur after the reporting period but before the financial statements are authorised for issue, the per share calculations for those and any prior period financial statements presented shall be based on the new number of shares. The fact that per share calculations reflect such changes in the number of shares shall be disclosed. In addition, basic and diluted earnings per share of all periods presented shall be adjusted for the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively.**

65 An entity does not restate diluted earnings per share of any prior period presented for changes in the assumptions used in earnings per share calculations or for the conversion of potential ordinary shares into ordinary shares.

Presentation

66 **An entity shall present in the statement of comprehensive income basic and diluted earnings per share for profit or loss from continuing operations attributable to the ordinary equity holders of the parent entity and for profit or loss attributable to the ordinary equity holders of the parent entity for the period for each class of ordinary shares that has a different right to share in profit for the period. An entity shall present basic and diluted earnings per share with equal prominence for all periods presented.**

67 Earnings per share is presented for every period for which a statement of comprehensive income is presented. If diluted earnings per share is reported for at least one period, it shall be reported for all periods presented, even if it equals basic earnings per share. If basic and diluted earnings per share are equal, dual presentation can be accomplished in one line in the statement of comprehensive income.

67A If an entity presents ~~the components~~items of profit or loss in a separate ~~income~~ statement as described in paragraph ~~81~~10A of HKAS 1 (as ~~revised~~amended in ~~2007~~2011), it presents basic and diluted earnings per share, as required in paragraphs 66 and 67, in that separate statement.

68 **An entity that reports a discontinued operation shall disclose the basic and diluted amounts per share for the discontinued operation either in the statement of comprehensive income or in the notes.**

68A If an entity presents ~~the components~~items of profit or loss in a separate ~~income~~ statement as described in paragraph ~~81~~10A of HKAS 1 (as ~~revised~~amended in ~~2007~~2011), it presents basic and diluted earnings per share for the discontinued operation, as required in paragraph 68, in that separate statement or in the notes.

69 **An entity shall present basic and diluted earnings per share, even if the amounts are negative (ie a loss per share).**

shares outstanding and any consequent adjustments to profit or loss attributable to ordinary equity holders. The disclosure of the terms and conditions of such financial instruments and other contracts is encouraged, if not otherwise required (see HKFRS 7 *Financial Instruments: Disclosures*).

73 **If an entity discloses, in addition to basic and diluted earnings per share, amounts per share using a reported component of the statement of comprehensive income other than one required by this Standard, such amounts shall be calculated using the weighted average number of ordinary shares determined in accordance with this Standard. Basic and diluted amounts per share relating to such a component shall be disclosed with equal prominence and presented in the notes. An entity shall indicate the basis on which the numerator(s) is (are) determined, including whether amounts per share are before tax or after tax. If a component of the statement of comprehensive income is used that is not reported as a line item in the statement of comprehensive income, a reconciliation shall be provided between the component used and a line item that is reported in the statement of comprehensive income.**

73A **Paragraph 73 applies also to an entity that discloses, in addition to basic and diluted earnings per share, amounts per share using a reported ~~component~~item of ~~the separate income statement (as described in paragraph 81 of HKAS 1 (as revised in 2007))~~profit or loss, other than one required by this Standard.**

Effective date

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

74a **If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.**

74A **HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it added paragraphs 4A, 67A, 68A and 73A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.**

74B **HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 4, 40 and A11. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.**

74C **HKFRS 13, issued in June 2011, amended paragraphs 8, 47A and A2. An entity shall apply those amendments when it applies HKFRS 13.**

74D ***Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraphs 4A, 67A, 68A and 73A. An entity shall apply those amendments when it applies HKAS 1 as amended in July 2011.**

Withdrawal of other pronouncements

75 This Standard supersedes SSAP 5 *Earnings Per Share* revised in 1998.

76 This Standard supersedes Interpretation 10 *Earnings Per Share—Financial Instruments and Other Contracts that May Be Settled in Shares.*

Appendix A
Application guidance

This appendix is an integral part of the Standard.

Profit or loss attributable to the parent entity

A1 For the purpose of calculating earnings per share based on the consolidated financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for non-controlling interests.

Rights issues

A2 The issue of ordinary shares at the time of exercise or conversion of potential ordinary shares does not usually give rise to a bonus element. This is because the potential ordinary shares are usually issued for ~~full~~fair value, resulting in a proportionate change in the resources available to the entity. In a rights issue, however, the exercise price is often less than the fair value of the shares. Therefore, as noted in paragraph 27(b), such a rights issue includes a bonus element. If a rights issue is offered to all existing shareholders, the number of ordinary shares to be used in calculating basic and diluted earnings per share for all periods before the rights issue is the number of ordinary shares outstanding before the issue, multiplied by the following factor:

$$\frac{\text{Fair value per share immediately before the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate ~~market~~ fair value of the shares immediately before the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights are to be publicly traded separately from the shares before the exercise date, fair value ~~for the purposes of this calculation~~ is ~~established~~measured at the close of the last day on which the shares are traded together with the rights.

Control number

A3 To illustrate the application of the control number notion described in paragraphs 42 and 43, assume that an entity has profit from continuing operations attributable to the parent entity of CU4,800[*], a loss from discontinued operations attributable to the parent entity of (CU7,200), a loss attributable to the parent entity of (CU2,400), and 2,000 ordinary shares and 400 potential ordinary shares outstanding. The entity's basic earnings per share is CU2.40 for continuing operations, (CU3.60) for discontinued operations and (CU1.20) for the loss. The 400 potential ordinary shares are included in the diluted earnings per share calculation because the resulting CU2.00 earnings per share for continuing operations is dilutive, assuming no profit or

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

A9 The underlying terms of certain options or warrants may require the proceeds received from the exercise of those instruments to be applied to redeem debt or other instruments of the entity (or its parent or a subsidiary). In the calculation of diluted earnings per share, those options or warrants are assumed to be exercised and the proceeds applied to purchase the debt at its average market price rather than to purchase ordinary shares. However, the excess proceeds received from the assumed exercise over the amount used for the assumed purchase of debt are considered (ie assumed to be used to buy back ordinary shares) in the diluted earnings per share calculation. Interest (net of tax) on any debt assumed to be purchased is added back as an adjustment to the numerator.

Written put options

A10 To illustrate the application of paragraph 63, assume that an entity has outstanding 120 written put options on its ordinary shares with an exercise price of CU35. The average market price of its ordinary shares for the period is CU28. In calculating diluted earnings per share, the entity assumes that it issued 150 shares at CU28 per share at the beginning of the period to satisfy its put obligation of CU4,200. The difference between the 150 ordinary shares issued and the 120 ordinary shares received from satisfying the put option (30 incremental ordinary shares) is added to the denominator in calculating diluted earnings per share.

Instruments of subsidiaries, joint ventures or associates

A11 Potential ordinary shares of a subsidiary, joint venture or associate convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent~~,~~ or investors with joint control of, or significant influence ~~venturer or investor~~ (the reporting entity) over, the investee are included in the calculation of diluted earnings per share as follows:

(a) instruments issued by a subsidiary, joint venture or associate that enable their holders to obtain ordinary shares of the subsidiary, joint venture or associate are included in calculating the diluted earnings per share data of the subsidiary, joint venture or associate. Those earnings per share are then included in the reporting entity's earnings per share calculations based on the reporting entity's holding of the instruments of the subsidiary, joint venture or associate.

(b) instruments of a subsidiary, joint venture or associate that are convertible into the reporting entity's ordinary shares are considered among the potential ordinary shares of the reporting entity for the purpose of calculating diluted earnings per share. Likewise, options or warrants issued by a subsidiary, joint venture or associate to purchase ordinary shares of the reporting entity are considered among the potential ordinary shares of the reporting entity in the calculation of consolidated diluted earnings per share.

A12 For the purpose of determining the earnings per share effect of instruments issued by a reporting entity that are convertible into ordinary shares of a subsidiary, joint venture or associate, the instruments are assumed to be converted and the numerator (profit or loss attributable to ordinary equity holders of the parent entity) adjusted as necessary in accordance with paragraph 33. In addition to those adjustments, the numerator is adjusted for any change in the profit or loss recorded by the reporting entity (such as dividend income or equity method

HKFRS 7
Revised ~~February 2012~~May 2014

Effective for annual periods
beginning on or after 1 January 2007

Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

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CONTENTS

Hong Kong Financial Reporting Standard 7 *Financial Instruments: Disclosures* (HKFRS 7) is set out in paragraphs 1-45 and Appendices A-D. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 7 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the HKFRS

IN1 In recent years, the techniques used by entities for measuring and managing exposure to risks arising from financial instruments have evolved and new risk management concepts and approaches have gained acceptance. In addition, many public and private sector initiatives have proposed improvements to the disclosure framework for risks arising from financial instruments.

IN2 The Hong Kong Institute of Certified Public Accountants (Institute) believes that users of financial statements need information about an entity's exposure to risks and how those risks are managed. Such information can influence a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows. Greater transparency regarding those risks allows users to make more informed judgements about risk and return.

IN3 Consequently, the Institute agreed that there was a need to revise and enhance the disclosures in HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and HKAS 32 *Financial Instruments: Disclosure and Presentation*. As part of this revision, the Institute removed duplicative disclosures and simplified the disclosures about concentrations of risk, credit risk, liquidity risk and market risk in HKAS 32.

Main features of the HKFRS

IN4 HKFRS 7 applies to all risks arising from all financial instruments, except those instruments listed in paragraph 3. The HKFRS applies to all entities, including entities that have few financial instruments (eg a manufacturer whose only financial instruments are accounts receivable and accounts payable) and those that have many financial instruments (eg a financial institution most of whose assets and liabilities are financial instruments). However, the extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risk.

IN5 The HKFRS requires disclosure of:

(a) the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in HKAS 32.

(b) qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

IN5A Amendments to the HKFRS, issued in March 2009, require enhanced disclosures about fair value measurements and liquidity risk. These have been made to address application issues and provide useful information to users.

IN5B *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7), issued in October 2010, amended the required disclosures to help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position.

IN5C In June 2011 the HKICPA relocated the disclosures about fair value measurements to HKFRS 13 *Fair Value Measurement*.

IN6 The HKFRS includes in Appendix B mandatory application guidance that explains how to apply the requirements in the HKFRS. The HKFRS is accompanied by non-mandatory Implementation Guidance that describes how an entity might provide the disclosures required by the HKFRS.

IN7 The HKFRS supersedes HKAS 30 and the disclosure requirements of HKAS 32. The presentation requirements of HKAS 32 remain unchanged.

IN8 The HKFRS is effective for annual periods beginning on or after 1 January 2007. Earlier application is encouraged.

IN9 *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to HKFRS 7), issued in December 2011, amended the required disclosures to include information that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position.

Hong Kong Financial Reporting Standard 7

Financial Instruments: Disclosures

Objective

1 The objective of this HKFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

2 The principles in this HKFRS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in HKAS 32 *Financial Instruments: Presentation* and HKAS 39 *Financial Instruments: Recognition and Measurement*.

Scope

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKFRS 10, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ require or permit~~s~~ an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; in those cases, entities shall apply the requirements of this HKFRS and, for those measured at fair value, the requirements of HKFRS 13 *Fair Value Measurement*. Entities shall also apply this HKFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in HKAS 32.

(b) employers' rights and obligations arising from employee benefit plans, to which HKAS 19 *Employee Benefits* applies.

(c) [deleted]

(d) insurance contracts as defined in HKFRS 4 *Insurance Contracts*. However, this HKFRS applies to derivatives that are embedded in insurance contracts if HKAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this HKFRS to *financial guarantee contracts* if the issuer applies HKAS 39 in recognising and measuring the contracts, but shall apply HKFRS 4 if the issuer elects, in accordance with paragraph 4(d) of HKFRS 4, to apply HKFRS 4 in recognising and measuring them.

(e) financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2 *Share-based Payment* applies, except that this HKFRS applies to contracts within the scope of paragraphs 5-7 of HKAS 39.

(f) instruments that are required to be classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of HKAS 32.

4 This HKFRS applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of HKAS 39. Unrecognised financial instruments include some financial instruments that, although outside the scope of HKAS 39, are within the scope of this HKFRS (such as some loan commitments).

5 This HKFRS applies to contracts to buy or sell a non-financial item that are within the scope of HKAS 39 (see paragraphs 5-7 of HKAS 39).

Classes of financial instruments and level of disclosure

6 When this HKFRS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

Significance of financial instruments for financial position and performance

7 An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

Statement of financial position

Categories of financial assets and financial liabilities

8 The carrying amounts of each of the following categories, as defined in HKAS 39, shall be disclosed either in the statement of financial position or in the notes:

(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with HKAS 39;

(b) held-to-maturity investments;

(c) loans and receivables;

(d) available-for-sale financial assets;

(e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with HKAS 39; and

(f) financial liabilities measured at amortised cost.

Financial assets or financial liabilities at fair value through profit or loss

9 If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss, it shall disclose:

(a) the maximum exposure to *credit risk* (see paragraph 36(a)) of the loan or receivable (or group of loans or receivables) at the end of the reporting period.

(b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

(c) the amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:

(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to *market risk*; or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.

(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.

10 If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 9 of HKAS 39, it shall disclose:

(a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:

(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix B, paragraph B4); or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

(b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

11 The entity shall disclose:

(a) the methods used to comply with the requirements in paragraphs 9(c) and 10(a).

(b) if the entity believes that the disclosure it has given to comply with the requirements in paragraph 9(c) or 10(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

Reclassification

12. If the entity has reclassified a financial asset (in accordance with paragraphs 51-54 of HKAS 39) as one measured:

(a) at cost or amortised cost, rather than fair value; or

(b) at fair value, rather than at cost or amortised cost,

it shall disclose the amount reclassified into and out of each category and the reason for that reclassification.

12A. If the entity has reclassified a financial asset out of the fair value through profit or loss category in accordance with paragraph 50B or 50D of HKAS 39 or out of the available-for-sale category in accordance with paragraph 50E of HKAS 39, it shall disclose:

(a) the amount reclassified into and out of each category;

(b) for each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;

(c) if a financial asset was reclassified in accordance with paragraph 50B, the rare situation, and the facts and circumstances indicating that the situation was rare;

(d) for the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognised in profit or loss or other comprehensive income in that reporting period and in the previous reporting period;

(e) for each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income if the financial asset had not been reclassified, and the gain, loss, income and expense recognised in profit or loss; and

(f) the effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.

13 [Deleted]

Offsetting financial assets and financial liabilities

13A The disclosures in paragraphs 13B–13E supplement the other disclosure requirements of this HKFRS and are required for all recognised financial instruments that are set off in accordance with paragraph 42 of HKAS 32. These disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 42 of HKAS 32.

13B An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. This includes the effect or potential effect of rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities that are within the scope of paragraph 13A.

13C To meet the objective in paragraph 13B, an entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities that are within the scope of paragraph 13A:

(a) the gross amounts of those recognised financial assets and recognised financial liabilities;

(b) the amounts that are set off in accordance with the criteria in paragraph 42 of HKAS 32 when determining the net amounts presented in the statement of financial position;

(c) the net amounts presented in the statement of financial position;

(d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b), including:

(i) amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of HKAS 32; and

(ii) amounts related to financial collateral (including cash collateral); and

(e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

The information required by this paragraph shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

13D The total amount disclosed in accordance with paragraph 13C(d) for an instrument shall be limited to the amount in paragraph 13C(c) for that instrument.

13E An entity shall include a description in the disclosures of the rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 13C(d), including the nature of those rights.

13F If the information required by paragraphs 13B–13E is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

Collateral

14 An entity shall disclose:

(a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 37(a) of HKAS 39; and

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

15 When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

(a) the fair value of the collateral held;

(b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and

(c) the terms and conditions associated with its use of the collateral.

Allowance account for credit losses

16 When financial assets are impaired by credit losses and the entity records the impairment in a separate account (eg an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.

Compound financial instruments with multiple embedded derivatives

17 If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 28 of HKAS 32) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and breaches

18 For *loans payable* recognised at the end of the reporting period, an entity shall disclose:

(a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

(b) the carrying amount of the loans payable in default at the end of the reporting period; and

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

19 If, during the period, there were breaches of loan agreement terms other than those described in paragraph 18, an entity shall disclose the same information as required by paragraph 18 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

Statement of comprehensive income

Items of income, expense, gains or losses

20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:

(a) net gains or net losses on:

(i) financial assets or financial liabilities at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with HKAS 39;

(ii) available-for-sale financial assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified from equity to profit or loss for the period;

(iii) held-to-maturity investments;

(iv) loans and receivables; and

(v) financial liabilities measured at amortised cost;

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

(c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:

   (i) financial assets or financial liabilities that are not at fair value through profit or loss; and

   (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;

(d) interest income on impaired financial assets accrued in accordance with paragraph AG93 of HKAS 39; and

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

Other disclosures

Accounting policies

21 In accordance with paragraph 117 of HKAS 1 *Presentation of Financial Statements* (as revised 2007), an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

Hedge accounting

22 An entity shall disclose the following separately for each type of hedge described in HKAS 39 (ie fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):

(a) a description of each type of hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and

(c) the nature of the risks being hedged.

23 For cash flow hedges, an entity shall disclose:

(a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

(b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

(c) the amount that was recognised in other comprehensive income during the period;

(d) the amount that was reclassified from equity to profit or loss for the period, showing the amount included in each line item in the statement of comprehensive income; and

(e) the amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.

24 An entity shall disclose separately:

(a) in fair value hedges, gains or losses:

(i) on the hedging instrument; and

(ii) on the hedged item attributable to the hedged risk.

(b) the ineffectiveness recognised in profit or loss that arises from cash flow hedges.

(c) the ineffectiveness recognised in profit or loss that arises from hedges of net investments in foreign operations.

Fair value

25 Except as set out in paragraph 29, for each class of financial assets and financial liabilities (see paragraph 6), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

26 In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.

27-27B [Deleted]

~~27 An entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.~~

~~27A To make the disclosures required by paragraph 27B an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:~~

~~(a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);~~

~~(b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices) (Level 2); and~~

~~(c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).~~

~~The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.~~

~~27B For fair value measurements recognised in the statement of financial position an entity shall disclose for each class of financial instruments:~~

~~(a) the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 27A.~~

~~(b) any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.~~

~~(c) for fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:~~

~~(i) total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented);~~

~~(ii) total gains or losses recognised in other comprehensive income;~~

~~(iii) purchases, sales, issues and settlements (each type of movement disclosed separately); and~~

~~(iv) transfers into or out of Level 3 (eg transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.~~

~~(d) the amount of total gains or losses for the period in (c)(i) above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of comprehensive income or the separate income statement (if presented).~~

~~(e) for fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.~~

~~An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.~~

28 ~~If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG74-AG79 of HKAS 39). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless conditions described in paragraph AG76 of HKAS 39 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:~~In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph AG76 of HKAS 39). In such cases, the entity shall disclose by class of financial asset or financial liability.

(a) its accounting policy for recognising in profit or loss the ~~that~~ difference between the fair value at initial recognition and the transaction price ~~in profit or loss~~ to reflect a change in factors (including time) that market participants would ~~consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~AG76A~~ AG76(b) of HKAS 39). ~~; and~~

(b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

(c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

29 Disclosures of fair value are not required:

(a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;

(b) for an investment in equity instruments that do not have a quoted market price in an active market for an identical instrument (ie a Level 1 input), or derivatives linked to such equity instruments, that is measured at cost in accordance with HKAS 39 because its fair value cannot otherwise be measured reliably; or

(c) for a contract containing a discretionary participation feature (as described in HKFRS 4) if the fair value of that feature cannot be measured reliably.

30 In the cases described in paragraph 29(b) and (c), an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:

(a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;

(b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;

(c) information about the market for the instruments;

(d) information about whether and how the entity intends to dispose of the financial instruments; and

(e) if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

Nature and extent of risks arising from financial instruments

31 An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

32 The disclosures required by paragraphs 33-42 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, *liquidity risk* and market risk.

32A Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

Qualitative disclosures

33 For each type of risk arising from financial instruments, an entity shall disclose:

(a) the exposures to risk and how they arise;

(b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and

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

Quantitative disclosures

34 For each type of risk arising from financial instruments, an entity shall disclose:

(a) summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in HKAS 24 *Related Party Disclosures*), for example the entity's board of directors or chief executive officer.

(b) the disclosures required by paragraphs 36-42, to the extent not provided in accordance with (a).

(c) concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

35 If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

Credit risk

36 An entity shall disclose by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with HKAS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(b) a description of collateral held as security and of other credit enhancements, and their financial effect (eg a quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).

(c) information about the credit quality of financial assets that are neither *past due* nor impaired.

(d) [deleted]

Financial assets that are either past due or impaired

37 An entity shall disclose by class of financial asset:

(a) an analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired; and

(b) an analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired.

(c) [deleted]

Collateral and other credit enhancements obtained

38 When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (eg guarantees), and such assets meet the recognition criteria in other HKFRSs, an entity shall disclose for such assets held at the reporting date:

(a) the nature and carrying amount of the assets; and

(b) when the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

Liquidity risk

39 An entity shall disclose:

(a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

(b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph B11B).

(c) a description of how it manages the liquidity risk inherent in (a) and (b).

Market risk

Sensitivity analysis

40 Unless an entity complies with paragraph 41, it shall disclose:

(a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

(b) the methods and assumptions used in preparing the sensitivity analysis; and

(c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

41 If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (eg interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 40. The entity shall also disclose:

(a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and

(b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

Other market risk disclosures

42 When the sensitivity analyses disclosed in accordance with paragraph 40 or 41 are unrepresentative of a risk inherent in a financial instrument (for example because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

Transfers of financial assets

42A The disclosure requirements in paragraphs 42B–42H relating to transfers of financial assets supplement the other disclosure requirements of this IFRS. An entity shall present the disclosures required by paragraphs 42B–42H in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred. For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either:

(a) transfers the contractual rights to receive the cash flows of that financial asset; or

(b) retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.

42B An entity shall disclose information that enables users of its financial statements:

(a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and

(b) to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets.

42C For the purposes of applying the disclosure requirements in paragraphs 42E–42H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 42E–42H, the following do not constitute continuing involvement:

(a) normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;

(b) forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or

(c) an arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 19(a)–(c) of HKAS 39 are met.

Transferred financial assets that are not derecognised in their entirety

42D An entity may have transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition. To meet the objectives set out in paragraph 42B(a), the entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognised in their entirety:

(a) the nature of the transferred assets.

(b) the nature of the risks and rewards of ownership to which the entity is exposed.

(c) a description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets.

(d) when the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).

(e) when the entity continues to recognise all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.

(f) when the entity continues to recognise the assets to the extent of its continuing involvement (see paragraphs 20(c)(ii) and 30 of HKAS 39), the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

Transferred financial assets that are derecognised in their entirety

42E To meet the objectives set out in paragraph 42B(b), when an entity derecognises transferred financial assets in their entirety (see paragraph 20(a) and (c)(i) of HKAS 39) but has continuing involvement in them, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:

(a) the carrying amount of the assets and liabilities that are recognised in the entity's statement of financial position and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which the carrying amount of those assets and liabilities are recognised.

(b) the fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets.

(c) the amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and information showing how the maximum exposure to loss is determined.

(d) the undiscounted cash outflows that would or may be required to repurchase derecognised financial assets (eg the strike price in an option agreement) or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.

(e) a maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.

(f) qualitative information that explains and supports the quantitative disclosures required in (a)–(e).

42F An entity may aggregate the information required by paragraph 42E in respect of a particular asset if the entity has more than one type of continuing involvement in that derecognised financial asset, and report it under one type of continuing involvement.

42G In addition, an entity shall disclose for each type of continuing involvement:

(a) the gain or loss recognised at the date of transfer of the assets.

(b) income and expenses recognised, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognised financial assets (eg fair value changes in derivative instruments).

(c) if the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):

(i) when the greatest transfer activity took place within that reporting period (eg the last five days before the end of the reporting period),

(ii) the amount (eg related gains or losses) recognised from transfer activity in that part of the reporting period, and

(iii) the total amount of proceeds from transfer activity in that part of the reporting period.

An entity shall provide this information for each period for which a statement of comprehensive income is presented.

Supplementary information

42H An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 42B.

Effective date and transition

43 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2007. Earlier application is encouraged. If an entity applies this HKFRS for an earlier period, it shall disclose that fact.

44 If an entity applies this HKFRS for annual periods beginning before 1 January 2006, it need not present comparative information for the disclosures required by paragraphs 31-42 about the nature and extent of risks arising from financial instruments.

44A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 20, 21, 23(c) and (d), 27(c) and B5 of Appendix B. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

44B HKFRS 3 (as revised in 2008) deleted paragraph 3(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. However, the amendment does not apply to contingent consideration that arose from a business combination for which the acquisition date preceded the application of HKFRS 3 (revised 2008). Instead, an entity shall account for such consideration in accordance with paragraphs 65A–65E of HKFRS 3 (as amended in 2010).

44C An entity shall apply the amendment in paragraph 3 for annual periods beginning on or after 1 January 2009. If an entity applies *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to HKAS 32 and HKAS 1), issued in June 2008, for an earlier period, the amendment in paragraph 3 shall be applied for that earlier period.

44D Paragraph 3(a) was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 1 of HKAS 28, paragraph 1 of HKAS 31 and paragraph 4 of HKAS 32 issued in October 2008. An entity is permitted to apply the amendment prospectively.

44E *Reclassification of Financial Assets* (Amendments to HKAS 39 and HKFRS 7), issued in October 2008, amended paragraph 12 and added paragraph 12A. An entity shall apply those amendments on or after 1 July 2008.

44F *Reclassification of Financial Assets—Effective Date and Transition* (Amendments to HKAS 39 and HKFRS 7), issued in December 2008, amended paragraph 44E. An entity shall apply that amendment on or after 1 July 2008.

44G *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7), issued in March 2009, amended paragraphs 27, 39 and B11 and added paragraphs 27A, 27B, B10A and B11A–B11F. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. An entity need not provide the disclosures required by the amendments for:

(a) any annual or interim period, including any statement of financial position, presented within an annual comparative period ending before 31 December 2009, or

(b) any statement of financial position as at the beginning of the earliest comparative period as at a date before 31 December 2009.

Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.*

44H-44J *[These paragraphs refer to amendments with an effective date after 1 January 2013, and are therefore not included in this edition.]*

44K Paragraph 44B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

44L *Improvements to HKFRSs* issued in May 2010 added paragraph 32A and amended paragraphs 34 and 36–38. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

44M *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7), issued in October 2010, deleted paragraph 13 and added paragraphs 42A–42H and B29–B39. An entity shall apply those amendments for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies the amendments from an earlier date, it shall disclose that fact. An entity need not provide the disclosures required by those amendments for any period presented that begins before the date of initial application of the amendments.

44N ~~[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]~~

44O HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 3. An entity shall apply that amendment when it applies HKFRS 10 and HKFRS 11.

44P HKFRS 13, issued in June 2011, amended paragraphs 3, 28 and 29 and Appendix A and deleted paragraphs 27-27B. An entity shall apply those amendments when it applies HKFRS 13.

44Q *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraph 27B. An entity shall apply that amendment when it applies HKAS 1 as amended in June 2011.

44R *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to HKFRS 7), issued in December 2011, added paragraphs 13A-13F and B40-B53. An entity shall apply those amendments for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. An entity shall provide the disclosures required by those amendments retrospectively.

* Paragraph 44G was amended as a consequence of *Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters* (Amendment to HKFRS 1) issued in February 2010. The HKICPA amended paragraph 44G to clarify its conclusions and intended transition for *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7).

Withdrawal of HKAS 30

45 This HKFRS supersedes HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

credit risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
liquidity risk	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.
loans payable	Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.
market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: **currency risk**, **interest rate risk** and **other price risk**.
other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from **interest rate risk** or **currency risk**), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or by factors affecting all similar financial instruments traded in the market.
past due	A financial asset is past due when a counterparty has failed to make a payment when contractually due.

The following terms are defined in paragraph 11 of HKAS 32 or paragraph 9 of HKAS 39 and are used in the HKFRS with the meaning specified in HKAS 32 and HKAS 39.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- equity instrument
- fair value
- financial asset
- financial asset or financial liability at fair value through profit or loss
- financial asset or financial liability held for trading

- financial guarantee contract
- financial instrument
- financial liability
- forecast transaction
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale

Appendix B
Application guidance

This appendix is an integral part of the HKFRS.

Classes of financial instruments and level of disclosure (paragraph 6)

B1 Paragraph 6 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 6 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in HKAS 39 (which determine how financial instruments are measured and where changes in fair value are recognised).

B2 In determining classes of financial instrument, an entity shall, at a minimum:

(a) distinguish instruments measured at amortised cost from those measured at fair value.

(b) treat as a separate class or classes those financial instruments outside the scope of this HKFRS.

B3 An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this HKFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

Significance of financial instruments for financial position and performance

Financial liabilities at fair value through profit or loss (paragraphs 10 and 11)

B4 If an entity designates a financial liability as at fair value through profit or loss, paragraph 10(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 10(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:

(a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

(b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).

(c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 10(a).

Other disclosure — accounting policies (paragraph 21)

B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a) for financial assets or financial liabilities designated as at fair value through profit or loss:

(i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;

(ii) the criteria for so designating such financial assets or financial liabilities on initial recognition; and

(iii) how the entity has satisfied the conditions in paragraph 9, 11A or 12 of HKAS 39 for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in HKAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in HKAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

(b) the criteria for designating financial assets as available for sale.

(c) whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 38 of HKAS 39).

(d) when an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:

(i) the criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and

(ii) the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 16).

(e) how net gains or net losses on each category of financial instrument are determined (see paragraph 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income.

(f) the criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 20(e)).

(g) when the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms.

Paragraph 122 of HKAS 1 (as revised in 2007) also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Nature and extent of risks arising from financial instruments (paragraphs 31-42)

B6 The disclosures required by paragraphs 31-42 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

Quantitative disclosures (paragraph 34)

B7 Paragraph 34(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and reliable information. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* discusses relevance and reliability.

B8 Paragraph 34(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgement taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

(a) a description of how management determines concentrations;

(b) a description of the shared characteristic that identifies each concentration (eg counterparty, geographical area, currency or market); and

(c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

Maximum credit risk exposure (paragraph 36(a))

B9 Paragraph 36(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

(a) any amounts offset in accordance with HKAS 32; and

(b) any impairment losses recognised in accordance with HKAS 39.

B10 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

(b) entering into derivative contracts, eg foreign exchange contracts, interest rate swaps and credit derivatives. When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.

(c) granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.

(d) making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognised as a liability.

Quantitative liquidity risk disclosures (paragraphs 34(a) and 39(a) and (b))

B10A In accordance with paragraph 34(a) an entity discloses summary quantitative data about its exposure to liquidity risk on the basis of the information provided internally to key management personnel. An entity shall explain how those data are determined. If the outflows of cash (or another financial asset) included in those data could either:

(a) occur significantly earlier than indicated in the data, or

(b) be for significantly different amounts from those indicated in the data (eg for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement),

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 39(a) or (b).

B11 In preparing the maturity analyses required by paragraph 39(a) and (b), an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(a) not later than one month;

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

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

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

B11A In complying with paragraph 39(a) and (b), an entity shall not separate an embedded derivative from a hybrid (combined) financial instrument. For such an instrument, an entity shall apply paragraph 39(a).

B11B Paragraph 39(b) requires an entity to disclose a quantitative maturity analysis for derivative financial liabilities that shows remaining contractual maturities if the contractual maturities are essential for an understanding of the timing of the cash flows. For example, this would be the case for:

(a) an interest rate swap with a remaining maturity of five years in a cash flow hedge of a variable rate financial asset or liability.

(b) all loan commitments.

B11C Paragraph 39(a) and (b) requires an entity to disclose maturity analyses for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure:

(a) when a counterparty has a choice of when an amount is paid, the liability is allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (eg demand deposits) are included in the earliest time band.

(b) when an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.

(c) for issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

B11D The contractual amounts disclosed in the maturity analyses as required by paragraph 39(a) and (b) are the contractual undiscounted cash flows, for example:

(a) gross finance lease obligations (before deducting finance charges);

(b) prices specified in forward agreements to purchase financial assets for cash;

(c) net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;

(d) contractual amounts to be exchanged in a derivative financial instrument (eg a currency swap) for which gross cash flows are exchanged; and

(e) gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

B11E Paragraph 39(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 39(a) and (b). An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (eg financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

B11F Other factors that an entity might consider in providing the disclosure required in paragraph 39(c) include, but are not limited to, whether the entity:

(a) has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs;

(b) holds deposits at central banks to meet liquidity needs;

(c) has very diverse funding sources;

(d) has significant concentrations of liquidity risk in either its assets or its funding sources;

(e) has internal control processes and contingency plans for managing liquidity risk;

(f) has instruments that include accelerated repayment terms (eg on the downgrade of the entity's credit rating);

(g) has instruments that could require the posting of collateral (eg margin calls for derivatives);

(h) has instruments that allow the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares; or

(i) has instruments that are subject to master netting agreements.

B12-B16 [Deleted]

Market risk — sensitivity analysis (paragraphs 40 and 41)

B17 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph B3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

(a) an entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.

(b) an entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

B18 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable (eg prevailing market interest rates, currency rates, equity prices or commodity prices). For this purpose:

(a) entities are not required to determine what the profit or loss for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on profit or loss and equity at the end of the reporting period assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on profit or loss (ie interest expense) for the current year if interest rates had varied by reasonably possible amounts.

(b) entities are not required to disclose the effect on profit or loss and equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

B19 In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

(a) the economic environments in which it operates. A reasonably possible change should not include remote or "worst case" scenarios or "stress tests". Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 per cent and an entity determines that a fluctuation in interest rates of ±50 basis points is reasonably possible. It would disclose the effect on profit or loss and equity if interest rates were to change to 4.5 per cent or 5.5 per cent. In the next period, interest rates have increased to 5.5 per cent. The entity continues to believe that interest rates may fluctuate by ±50 basis points (ie that the rate of change in interest rates is stable). The entity would disclose the effect on profit or loss and equity if interest rates were to change to 5 per cent or 6 per cent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by ±50 basis points, unless there is evidence that interest rates have become significantly more volatile.

(b) the time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

B20 Paragraph 41 permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 41(a) by disclosing the type of value-at-risk model used (eg whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (eg the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

B21 An entity shall provide sensitivity analyses for the whole of its business, but may provide different types of sensitivity analysis for different classes of financial instruments.

Interest rate risk

B22 *Interest rate risk* arises on interest-bearing financial instruments recognised in the statement of financial position (eg loans and receivables and debt instruments issued) and on some financial instruments not recognised in the statement of financial position (eg some loan commitments).

Currency risk

B23 *Currency risk* (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency, ie in a currency other than the functional currency in which they are measured. For the purpose of this HKFRS, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.

B24 A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

Other price risk

B25 *Other price risk* arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 40, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.

B26 Two examples of financial instruments that give rise to equity price risk are (a) a holding of equities in another entity and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.

B27 In accordance with paragraph 40(a), the sensitivity of profit or loss (that arises, for example, from instruments classified as at fair value through profit or loss and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of equity (that arises, for example, from instruments classified as available for sale).

B28 Financial instruments that an entity classifies as equity instruments are not remeasured. Neither profit or loss nor equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

Derecognition (paragraphs 42C–42H)

Continuing involvement (paragraph 42C)

B29 The assessment of continuing involvement in a transferred financial asset for the purposes of the disclosure requirements in paragraphs 42E–42H is made at the level of the reporting entity. For example, if a subsidiary transfers to an unrelated third party a financial asset in which the parent of the subsidiary has continuing involvement, the subsidiary does not include the parent's involvement in the assessment of whether it has continuing involvement in the transferred asset in its separate or individual financial statements (ie when the subsidiary is the reporting entity). However, a parent would include its continuing involvement (or that of another member of the group) in a financial asset transferred by its subsidiary in determining whether it has continuing involvement in the transferred asset in its consolidated financial statements (ie when the reporting entity is the group).

B30 An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future.

B31 Continuing involvement in a transferred financial asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

Transferred financial assets that are not derecognised in their entirety (paragraph 42D)

B32 Paragraph 42D requires disclosures when part or all of the transferred financial assets do not qualify for derecognition. Those disclosures are required at each reporting date at which the entity continues to recognise the transferred financial assets, regardless of when the transfers occurred.

Types of continuing involvement (paragraphs 42E–42H)

B33 Paragraphs 42E–42H require qualitative and quantitative disclosures for each type of continuing involvement in derecognised financial assets. An entity shall aggregate its continuing involvement into types that are representative of the entity's exposure to risks. For example, an entity may aggregate its continuing involvement by type of financial instrument (eg guarantees or call options) or by type of transfer (eg factoring of receivables, securitisations and securities lending).

Maturity analysis for undiscounted cash outflows to repurchase transferred assets (paragraph 42E(e))

B34 Paragraph 42E(e) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognised financial assets or other amounts payable to the transferee in respect of the derecognised financial assets, showing the remaining contractual maturities of the entity's continuing involvement. This analysis distinguishes cash flows that are required to be paid (eg forward contracts), cash flows that the entity may be required to pay (eg written put options) and cash flows that the entity might choose to pay (eg purchased call options).

B35 An entity shall use its judgement to determine an appropriate number of time bands in preparing the maturity analysis required by paragraph 42E(e). For example, an entity might determine that the following maturity time bands are appropriate:

(a) not later than one month;

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

(c) later than three months and not later than six months;

(d) later than six months and not later than one year;

(e) later than one year and not later than three years;

(f) later than three years and not later than five years; and

(g) more than five years.

B36 If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or is permitted to pay.

Qualitative information (paragraph 42E(f))

B37 The qualitative information required by paragraph 42E(f) includes a description of the derecognised financial assets and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

(a) a description of how the entity manages the risk inherent in its continuing involvement in the derecognised financial assets.

(b) whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by parties whose interests rank lower than the entity's interest in the asset (ie its continuing involvement in the asset).

(c) a description of any triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

Gain or loss on derecognition (paragraph 42G(a))

B38 Paragraph 42G(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall disclose if a gain or loss on derecognition arose because the fair values of the components of the previously recognised asset (ie the interest in the asset derecognised and the interest retained by the entity) were different from the fair value of the previously recognised asset as a whole. In that situation, the entity shall also disclose whether the fair value measurements included significant inputs that were not based on observable market data, as described in paragraph 27A.

Supplementary information (paragraph 42H)

B39 The disclosures required in paragraphs 42D–42G may not be sufficient to meet the disclosure objectives in paragraph 42B. If this is the case, the entity shall disclose whatever additional information is necessary to meet the disclosure objectives. The entity shall decide, in the light of its circumstances, how much additional information it needs to provide to satisfy the information needs of users and how much emphasis it places on different aspects of the additional information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

Offsetting financial assets and financial liabilities (paragraphs 13A–13F)

Scope (paragraph 13A)

B40 The disclosures in paragraphs 13B–13E are required for all recognised financial instruments that are set off in accordance with paragraph 42 of HKAS 32. In addition, financial instruments are within the scope of the disclosure requirements in paragraphs 13B–13E if they are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set off in accordance with paragraph 42 of HKAS 32.

B41 The similar agreements referred to in paragraphs 13A and B40 include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements, and any related rights to financial collateral. The similar financial instruments and transactions referred to in paragraph B40 include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities borrowing, and securities lending agreements. Examples of financial instruments that are not within the scope of paragraph 13A are loans and customer deposits at the same institution (unless they are set off in the statement of financial position), and financial instruments that are subject only to a collateral agreement.

Disclosure of quantitative information for recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C)

B42 Financial instruments disclosed in accordance with paragraph 13C may be subject to different measurement requirements (for example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative will be measured at fair value). An entity shall include instruments at their recognised amounts and describe any resulting measurement differences in the related disclosures.

Disclosure of the gross amounts of recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C(a))

B43 The amounts required by paragraph 13C(a) relate to recognised financial instruments that are set off in accordance with paragraph 42 of HKAS 32. The amounts required by paragraph 13C(a) also relate to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria. However, the disclosures required by paragraph 13C(a) do not relate to any amounts recognised as a result of collateral agreements that do not meet the offsetting criteria in paragraph 42 of HKAS 32. Instead, such amounts are required to be disclosed in accordance with paragraph 13C(d).

Disclosure of the amounts that are set off in accordance with the criteria in paragraph 42 of HKAS 32 (paragraph 13C(b))

B44 Paragraph 13C(b) requires that entities disclose the amounts set off in accordance with paragraph 42 of HKAS 32 when determining the net amounts presented in the statement of financial position. The amounts of both the recognised financial assets and the recognised financial liabilities that are subject to set-off under the same arrangement will be disclosed in both the financial asset and financial liability disclosures. However, the amounts disclosed (in, for example, a table) are limited to the amounts that are subject to set-off. For example, an entity may have a recognised derivative asset and a recognised derivative liability that meet the offsetting criteria in paragraph 42 of HKAS 32. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the financial asset disclosure table will include the entire amount of the derivative asset (in accordance with paragraph 13C(a)) and the entire amount of the derivative liability (in accordance with paragraph 13C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with paragraph 13C(a)), it will only include the amount of the derivative asset (in accordance with paragraph 13C(b)) that is equal to the amount of the derivative liability.

Disclosure of the net amounts presented in the statement of financial position (paragraph 13C(c))

B45 If an entity has instruments that meet the scope of these disclosures (as specified in paragraph 13A), but that do not meet the offsetting criteria in paragraph 42 of HKAS 32, the amounts required to be disclosed by paragraph 13C(c) would equal the amounts required to be disclosed by paragraph 13C(a).

B46 The amounts required to be disclosed by paragraph 13C(c) must be reconciled to the individual line item amounts presented in the statement of financial position. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in paragraph 13C(c) back to the individual line item amounts presented in the statement of financial position.

Disclosure of the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) (paragraph 13C(d))

B47 Paragraph 13C(d) requires that entities disclose amounts that are subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b). Paragraph 13C(d)(i) refers to amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of HKAS 32 (for example, current rights of set-off that do not meet the criterion in paragraph 42(b) of HKAS 32, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties).

B48 Paragraph 13C(d)(ii) refers to amounts related to financial collateral, including cash collateral, both received and pledged. An entity shall disclose the fair value of those financial instruments that have been pledged or received as collateral. The amounts disclosed in accordance with paragraph 13C(d)(ii) should relate to the actual collateral received or pledged and not to any resulting payables or receivables recognised to return or receive back such collateral.

Limits on the amounts disclosed in paragraph 13C(d) (paragraph 13D)

B49 When disclosing amounts in accordance with paragraph 13C(d), an entity must take into account the effects of over-collateralisation by financial instrument. To do so, the entity must first deduct the amounts disclosed in accordance with paragraph 13C(d)(i) from the amount disclosed in accordance with paragraph 13C(c). The entity shall then limit the amounts disclosed in accordance with paragraph 13C(d)(ii) to the remaining amount in paragraph 13C(c) for the related financial instrument. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 13D.

Description of the rights of set-off subject to enforceable master netting arrangements and similar agreements (paragraph 13E)

B50 An entity shall describe the types of rights of set-off and similar arrangements disclosed in accordance with paragraph 13C(d), including the nature of those rights. For example, an entity shall describe its conditional rights. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining criteria in paragraph 42 of HKAS 32, the entity shall describe the reason(s) why the criteria are not met. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (for example, when the collateral is restricted).

Disclosure by type of financial instrument or by counterparty

B51 The quantitative disclosures required by paragraph 13C(a)–(e) may be grouped by type of financial instrument or transaction (for example, derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements).

B52 Alternatively, an entity may group the quantitative disclosures required by paragraph 13C(a)–(c) by type of financial instrument, and the quantitative disclosures required by paragraph 13C(c)–(e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of counterparties (Counterparty A, Counterparty B, Counterparty C, etc) shall remain consistent from year to year for the years presented to maintain comparability. Qualitative disclosures shall be considered so that further information can be given about the types of counterparties. When disclosure of the amounts in paragraph 13C(c)–(e) is provided by counterparty, amounts that are individually significant in terms of total counterparty amounts shall be separately disclosed and the remaining individually insignificant counterparty amounts shall be aggregated into one line item.

Other

B53 The specific disclosures required by paragraphs 13C–13E are minimum requirements. To meet the objective in paragraph 13B an entity may need to supplement them with additional (qualitative) disclosures, depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of set-off, and their effect or potential effect on the entity's financial position.

Appendix C
Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2007. If an entity applies the HKFRS for an earlier period, these amendments shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

Appendix D
Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Amendments to HKFRS 9 *Financial Instruments* and HKFRS 7 *Financial Instruments: Disclosures* – Mandatory Effective Date of HKFRS 9 and Transition Disclosures (issued in December 2011)

Paragraph 44I of HKFRS 7 is amended.

44I When an entity first applies HKFRS 9, it shall disclose for each class of financial assets <u>and financial liabilities</u> at the date of initial application:

(a) the original measurement category and carrying amount determined in accordance with HKAS 39;

(b) the new measurement category and carrying amount determined in accordance with HKFRS 9;

(c) the amount of any financial assets <u>and financial liabilities</u> in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated, distinguishing between those that HKFRS 9 requires an entity to reclassify and those that an entity elects to reclassify.

An entity shall present these quantitative disclosures in tabular format unless another format is more appropriate.

Paragraphs 44S–44W of HKFRS 7 are added.

44S When an entity first applies the classification and measurement requirements of HKFRS 9, it shall present the disclosures set out in paragraphs 44T–44W of this HKFRS if it elects to, or is required to, provide these disclosures in accordance with HKFRS 9 (see paragraph 8.2.12 of HKFRS 9 (2009) and paragraph 7.2.14 of HKFRS 9 (2010)).

44T If required by paragraph 44S, at the date of initial application of HKFRS 9 an entity shall disclose the changes in the classifications of financial assets and financial liabilities, showing separately:

(a) the changes in the carrying amounts on the basis of their measurement categories in accordance with HKAS 39 (ie not resulting from a change in measurement attribute on transition to HKFRS 9); and

(b) the changes in the carrying amounts arising from a change in measurement attribute on transition to HKFRS 9.

The disclosures in this paragraph need not be made after the annual period in which HKFRS 9 is initially applied.

44U In the reporting period in which HKFRS 9 is initially applied, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortised cost as a result of the transition to HKFRS 9:

(a) the fair value of the financial assets or financial liabilities at the end of the reporting period;

(b) the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets or financial liabilities had not been reclassified;

(c) the effective interest rate determined on the date of reclassification; and

(d) the interest income or expense recognised.

If an entity treats the fair value of a financial asset or a financial liability as its amortised cost at the date of initial application (see paragraph 8.2.10 of HKFRS 9 (2009) and paragraph 7.2.10 of HKFRS 9 (2010)), the disclosures in (c) and (d) of this paragraph shall be made for each reporting period following reclassification until derecognition. Otherwise, the disclosures in this paragraph need not be made after the reporting period containing the date of initial application.

44V If an entity presents the disclosures set out in paragraphs 44S–44U at the date of initial application of HKFRS 9, those disclosures, and the disclosures in paragraph 28 of HKAS 8 during the reporting period containing the date of initial application, must permit reconciliation between:

(a) the measurement categories in accordance with HKAS 39 and HKFRS 9; and

(b) the line items presented in the statements of financial position.

44W If an entity presents the disclosures set out in paragraphs 44S–44U at the date of initial application of HKFRS 9, those disclosures, and the disclosures in paragraph 25 of this HKFRS at the date of initial application, must permit reconciliation between:

(a) of the measurement categories presented in accordance with HKAS 39 and HKFRS 9; and

(b) the class of financial instrument at the date of initial application.

HKFRS 7 BC
Revised ~~February 2012~~May 2014

Basis for Conclusions on
Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

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

Basis for Conclusions
HKFRS 7 *Financial Instruments: Disclosures*

HKFRS 7 is based on IFRS 7 *Financial Instruments: Disclosures*. In approving HKFRS 7, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 7. Accordingly, there are no significant differences between HKFRS 7 and IFRS 7. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 7 referred to below generally correspond with those in HKFRS 7.

CONTENTS

Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*

This Basis for Conclusions accompanies, but is not part of, IFRS 7.

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

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 7 *Financial Instruments: Disclosures*. Individual Board members gave greater weight to some factors than to others.

BC2 During the late 1990s, the need for a comprehensive review of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* became apparent. The Board's predecessor, the International Accounting Standards Committee (IASC), issued a number of Standards that addressed, more comprehensively, some of the topics previously addressed only for banks in IAS 30. Also, fundamental changes were taking place in the financial services industry and in the way in which financial institutions manage their activities and risk exposures. This made it increasingly difficult for users of banks' financial statements to assess and compare their financial position and performance, their associated risk exposures, and their processes for measuring and managing those risks.

BC3 In 1999 IASC added a project to its agenda to revise IAS 30 and in 2000 it appointed a steering committee.

BC4 In 2001 the Board added this project to its agenda. To assist and advise it, the Board retained the IAS 30 steering committee, renamed the Financial Activities Advisory Committee (FAAC), as an expert advisory group. FAAC members had experience and expertise in banks, finance companies and insurance companies and included auditors, financial analysts, preparers and regulators. The FAAC's role was:

(a) to provide input from the perspective of preparers and auditors of financial statements of entities that have significant exposures to financial instruments; and

(b) to assist the Board in developing a standard and implementation guidance for risk disclosures arising from financial instruments and for other related disclosures.

BC5 The Board published its proposals in July 2004 as ED 7 *Financial Instruments: Disclosures*. The deadline for comments was 27 October 2004. The Board received 105 comment letters. After reviewing the responses, the Board issued IFRS 7 in August 2005.

BC5A In October 2008 the Board published an exposure draft *Improving Disclosures about Financial Instruments* (proposed amendments to IFRS 7). The aim of the proposed amendments was to enhance disclosures about fair value and liquidity risk. The Board received 89 comment letters. After reviewing the responses, the Board issued amendments to IFRS 7 in March 2009. The Board decided to require application of the amendments for periods beginning on or after 1 January 2009. The Board noted that, although the effective date of IFRSs and amendments to IFRSs is usually 6–18 months after issue, the urgent need for enhanced disclosures about financial instruments demanded earlier application.

BC5B In January 2011 the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. This was in response to requests from users of financial statements and recommendations from the Financial Stability Board to achieve convergence of the boards' requirements for offsetting financial assets and financial liabilities. The different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. The proposals in the exposure draft would have replaced the requirements for offsetting financial assets and financial liabilities and would have established a common approach with the FASB. After considering the responses to the exposure draft, the boards decided to maintain their respective offsetting models. However, to meet the needs of users of financial statements, the boards agreed jointly on additional disclosures to enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) was issued in December 2011 and is effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods.

Scope (paragraphs 3-5)

The entities to which the IFRS applies

BC6 Although IFRS 7 arose from a project to revise IAS 30 (a Standard that applied only to banks and similar financial institutions), it applies to all entities that have financial instruments. The Board observed that the reduction in regulatory barriers in many countries and increasing competition between banks, non-bank financial services firms, and financial conglomerates have resulted in many entities providing financial services that were traditionally provided only by entities regulated and supervised as banks. The Board concluded that this development would make it inappropriate to limit this project to banks and similar financial institutions.

BC7 The Board considered whether entities that undertake specified activities commonly undertaken by banks and other financial institutions, namely deposit-taking, lending and securities activities, face unique risks that would require a standard specific to them. However, the Board decided that the scope of this project should include disclosures about risks arising from financial instruments in all entities for the following reasons:

(a) disclosures about risks associated with financial instruments are useful to users of the financial statements of all entities.

(b) the Board found it could not satisfactorily define deposit-taking, lending, and securities activities. In particular, it could not satisfactorily differentiate an entity with securities activities from an entity holding a portfolio of financial assets for investment and liquidity management purposes.

(c) responses to the Exposure Draft of Improvements to IAS 32 *Financial Instruments: Disclosure and Presentation*, published in June 2002, indicated that IAS 32's risk disclosure requirements, applicable to all entities, could be improved.

(d) the exclusion of some financial instruments would increase the danger that risk disclosures could be incomplete and possibly misleading. For example, a debt instrument issued by an entity could significantly affect its exposures to liquidity risk, interest rate risk and currency risk even if that instrument is not held as part of deposit-taking, lending and securities activities.

(e) users of financial statements need to be able to compare similar activities, transactions and events of different entities on a consistent basis. Hence, the disclosure principles that apply to regulated entities should not differ from those that apply to non-regulated, but otherwise similar, entities.

BC8 The Board decided that the scope of the IFRS should be the same as that of IAS 32 with one exception. The Board concluded that the IFRS should not apply to derivatives based on interests in subsidiaries, associates or joint ventures if the derivatives meet the definition of an equity instrument in IAS 32. This is because equity instruments are not remeasured and hence:

(a) they do not expose the issuer to balance sheet and income statement risk; and

(b) the disclosures about the significance of financial instruments for financial position and performance are not relevant to equity instruments.

Although these instruments are excluded from the scope of IFRS 7, they are within the scope of IAS 32 for the purpose of determining whether they meet the definition of equity instruments.

Exemptions considered by the Board

Insurers

BC9 The Board considered whether the IFRS should apply to entities that both have financial instruments and issue insurance contracts. The Board did not exempt these entities because financial instruments expose all entities to risks regardless of what other assets and liabilities they have. Accordingly, an entity that both issues insurance contracts and has financial instruments applies IFRS 4 *Insurance Contracts* to its insurance contracts and IFRS 7 to its financial assets and financial liabilities. However, many of the disclosure requirements in IFRS 4 were applications of, or relatively straightforward analogies with, existing requirements in IAS 32. Therefore, the Board also updated the disclosures required by IFRS 4 to make them consistent with IFRS 7, with modifications that reflect the interim nature of IFRS 4.

Small and medium-sized entities

BC10 The Board considered whether it should exempt small and medium-sized entities from the scope of the IFRS. The Board noted that the extent of disclosures required by the IFRS will depend on the extent to which the entity uses financial instruments and the extent to which it has assumed associated risks. The IFRS requires entities with few financial instruments and few risks to give few disclosures. Also, many of the requirements in the IFRS are based on information provided internally to the entity's key management personnel. This helps to avoid unduly onerous requirements that would not be appropriate for smaller entities. Accordingly, the Board decided not to exempt such entities from the scope of IFRS 7. However, it will keep this decision under review in its project on financial reporting for small and medium-sized entities.

Subsidiaries

BC11 Some respondents to ED 7 stated that there is little public interest in the financial statements of some entities, such as a wholly-owned subsidiary whose parent issues publicly available financial statements. These respondents stated that such subsidiaries should be exempt from some of the requirements of IFRS 7 in their individual financial statements. However, deciding whether such an entity should prepare general purpose financial statements is a matter for the entity and local legislators and regulators. If such an entity prepares financial statements in accordance with IFRSs, users of those statements should receive information of the same quality as users of any general purpose financial statements prepared in accordance with IFRSs. The Board confirmed its view that no exemptions from the general requirements of any Standard should be given for the financial statements of subsidiaries.

Disclosures about the significance of financial instruments for financial position and performance (paragraphs 7-30, B4 and B5)

BC12 The Board relocated disclosures from IAS 32 to IFRS 7, so that all disclosure requirements for financial instruments are in one Standard. Many of the disclosure requirements about the significance of financial instruments for an entity's financial position and performance were previously in IAS 32. For these disclosures, the relevant paragraphs from the Basis for Conclusions on IAS 32 have been incorporated into this Basis for Conclusions. This Basis for Conclusions does not discuss requirements that the Board did not reconsider either in revising IAS 32 in 2003 or in developing IFRS 7.

The principle (paragraph 7)

BC13 The Board decided that the disclosure requirements of IFRS 7 should result from the explicit disclosure principle in paragraph 7. The Board also decided to specify disclosures to satisfy this principle. In the Board's view, entities could not satisfy the principle in paragraph 7 unless they disclose the information required by paragraphs 8-30.

Balance sheet disclosures (paragraphs 8-19 and B4)

Categories of financial assets and financial liabilities (paragraph 8)

BC14 Paragraph 8 requires entities to disclose financial assets and financial liabilities by the measurement categories in IAS 39 *Financial Instruments: Recognition and Measurement*. The Board concluded that the disclosure for each measurement category would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised.

BC15 The Board also concluded that separate disclosure of the carrying amounts of financial assets and financial liabilities that are classified as held for trading and those designated upon initial recognition as financial assets and financial liabilities at fair value through profit or loss is useful because such designation is at the discretion of the entity.

Financial assets or financial liabilities at fair value through profit or loss (paragraphs 9-11, B4 and B5)

BC16 IAS 39 permits entities to designate a non-derivative financial liability as at fair value through profit or loss, if specified conditions are met. If entities do so, they are required to provide the disclosures in paragraphs 10 and 11. The Board's reasons for these disclosures are set out in the Basis for Conclusions on IAS 39, paragraphs BC87-BC92.

BC17 The requirements in paragraphs 9, 11 and B5(a) are related to the Amendments to IAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option*, issued in June 2005. The reasons for those requirements are discussed in the Basis for Conclusions on those Amendments.

BC18 Paragraph 10(a) requires disclosure of the change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the liability's credit risk. The Board previously considered this disclosure in its deliberations on the fair value measurement of financial liabilities in IAS 39.

BC19 Although quantifying such changes might be difficult in practice, the Board concluded that disclosure of such information would be useful to users of financial statements and would help alleviate concerns that users may misinterpret the profit or loss effects of changes in credit risk, especially in the absence of disclosures. Therefore, in finalising the revisions to IAS 32 in 2003, it decided to require disclosure of the change in fair value of the financial liability that is not attributable to changes in a benchmark interest rate. The Board believed that this is often a reasonable proxy for the change in fair value that is attributable to changes in the liability's credit risk, in particular when such changes are large, and would provide users with information with which to understand the profit or loss effect of such a change in credit risk.

BC20 However, some respondents to ED 7 stated that they did not agree that the IAS 32 disclosure provided a reasonable proxy, except for straightforward debt instruments. In particular, there could be other factors involved in the change in an instrument's fair value unrelated to the benchmark interest rate, such as the effect of an embedded derivative. Respondents also cited difficulties for unit-linked insurance contracts, for which the amount of the liability reflects the performance of a defined pool of assets. The Board noted that the proxy that was developed in IAS 32 assumed that it is not practicable for entities to determine directly the change in fair value arising from changes in credit risk. However, the Board acknowledged and shared these concerns.

BC21 As a result, the Board amended this requirement to focus directly on the objective of providing information about the effects of changes in credit risk:

(a) by permitting entities to provide a more faithful representation of the amount of change in fair value that is attributable to changes in credit risk if they could do so. However, such entities are also required to disclose the methods used and provide their justification for concluding that those methods give a more faithful representation than the proxy in paragraph 10(a)(i).

(b) by amending the proxy disclosure to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. For example, some entities may be able to identify part of the change in the fair value of the liability as attributable to a change in an index. In these cases, the proxy disclosure would exclude the amount of change attributable to a change in an index. Similarly, excluding the amount attributable to a change in an internal or external investment fund makes the proxy more suitable for unit-linked insurance contracts.

BC22 The Board decided that when an entity has designated a financial liability as at fair value through profit or loss, it should disclose the difference between the carrying amount and the amount the entity would contractually be required to pay at maturity to the holders of the liability (see paragraph 10(b)). The fair value may differ significantly from the settlement amount, in particular for financial liabilities with a long duration when an entity has experienced a significant deterioration in creditworthiness since their issue. The Board concluded that knowledge of this difference would be useful to users of financial statements. Also, the settlement amount is important to some financial statement users, particularly creditors.

Reclassification (paragraphs 12 and 12A)

BC23 IAS 32 required disclosure of the reason for reclassification of financial assets at cost or amortised cost rather than at fair value. The Board extended this requirement to include disclosure of the reason for reclassifications and of the amount reclassified into and out of each category. As noted in paragraph BC14, the Board regards such information as useful because the categorisation of financial instruments has a significant effect on their measurement.

BC23A In October and November 2008 the Board amended IAS 39 to permit reclassification of particular financial assets in some circumstances. The Board decided to require additional disclosures about the situations in which any such reclassification is made, and the effects on the financial statements. The Board regards such information as useful because the reclassification of a financial asset can have a significant effect on the financial statements.

BC24 [Deleted]

Offsetting financial assets and financial liabilities

Background

BC24A Following requests from users of financial statements and recommendations from the Financial Stability Board, in June 2010 the IASB and the FASB added a project to their respective agendas to improve and potentially achieve convergence of the requirements for offsetting financial assets and financial liabilities. The different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.

BC24B Consequently, in January 2011 the IASB and the FASB published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. The exposure draft proposed common offsetting requirements for IFRSs and US GAAP and proposed disclosures about financial assets and financial liabilities that are subject to rights of set-off and related arrangements.

BC24C Most respondents to the exposure draft supported the boards' efforts towards achieving convergence, but their responses to the proposals varied. Many IFRS preparers agreed with the proposals, stating that the underlying principle and proposed criteria were similar to those in IAS 32 and reflect an entity's credit and liquidity exposure to such instruments. Some US GAAP preparers indicated that offsetting in the statement of financial position in accordance with the proposed criteria provided more relevant information than the current model, except for derivatives and repurchase or reverse repurchase agreements.

BC24D There was no consensus among users of financial statements regarding if, or when, to present gross or net information in the statement of financial position. However, there was consensus that both gross and net information are useful and necessary for analysing financial statements. Users of financial statements supported achieving convergence of the IFRS and US GAAP requirements, and also supported improving disclosures so that financial statements prepared in accordance with IFRSs and US GAAP would be more comparable. Comparable information is important to investors for calculating their ratios and performing their analyses.

BC24E As a result of the feedback received on the exposure draft, the IASB and the FASB decided to maintain their respective offsetting models. However, the boards noted that requiring common disclosures of gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position, would be helpful for users of financial statements. Accordingly, the boards agreed on common disclosure requirements by amending and finalising the disclosures initially proposed in the exposure draft.

Scope (paragraph 13A)

BC24F The disclosures in the exposure draft would have applied to all recognised financial assets and recognised financial liabilities subject to a right of set-off, and/or for which an entity had either received or pledged cash or other financial instruments as collateral.

BC24G Respondents to the exposure draft noted that paragraphs 14, 15 and 36(b) of IFRS 7 already require disclosures of financial instrument collateral received and pledged and other credit enhancements. US GAAP has similar disclosure requirements. Consequently, if an entity has no financial assets or financial liabilities subject to a right of set-off (other than collateral agreements or credit enhancements), the boards concluded that there would be no incremental value in providing additional disclosure information for such instruments.

BC24H For example, some respondents were concerned that providing disclosure of conditional rights to set off loans and customer deposits at the same financial institution would be a significant operational burden. Such rights are often a result of statute, and entities do not typically manage their credit risk related to such amounts based on these rights of set-off. In addition, entities that have contractual rights to set off customer deposits with loans only in situations such as events of default see these rights as a credit enhancement and not as the primary source of credit mitigation. Respondents argued that the cost of including these amounts in the amended disclosures would outweigh the benefit because users of financial statements did not request information related to these instruments when discussing the offsetting disclosure requirements.

BC24I The boards agreed and decided to limit the scope of the disclosures to all financial instruments that meet the boards' respective offsetting models and recognised financial assets and recognised financial liabilities that are subject to an enforceable master netting arrangement or a similar agreement. The boards specifically excluded loans and customer deposits with the same financial institution from the scope of these requirements (except in the limited cases when the respective offsetting model is satisfied). This reduced scope still responds to the needs of users of financial statements for information about amounts that have been set off in accordance with IFRSs and amounts that have been set off in accordance with US GAAP. The types of instruments that fall within the scope of these disclosures include the instruments that cause significant differences between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP.

BC24J If there is an associated collateral agreement for such instruments, an entity would disclose amounts subject to such agreements in order to provide full information about its exposure in the normal course of business, as well as in the events of default and insolvency or bankruptcy.

BC24K Other respondents requested that the scope of the proposed disclosures be further amended to exclude financial instruments for which the lender has the right to set off the related non-financial collateral in the event of default. Although non-financial collateral agreements may exist for some financial instruments, those preparers do not necessarily manage the credit risk related to such financial instruments on the basis of the non-financial collateral held.

BC24L The disclosures focus on the effects of recognised financial instruments and financial instrument set-off agreements on an entity's financial position. The boards also noted that a comprehensive reconsideration of credit risk disclosures was not within the scope of this project. They therefore restricted the scope of the disclosures to exclude financial instruments with rights of set-off only for non-financial collateral.

BC24M A few respondents were concerned that the proposals seem to be designed for financial institutions and would impose requirements on non-financial institutions. They questioned the benefit that such disclosures would provide to investors in non-financial entities.

BC24N Although the boards acknowledged that financial institutions would be among those most affected, they did not agree that the disclosures are only relevant for financial institutions. Other industries have similar financial instrument activities and use enforceable master netting arrangements and similar agreements to mitigate exposure to credit risks. Consequently, the boards concluded that the required disclosures provide useful information about an entity's arrangements, irrespective of the nature of the entity's business.

Disclosure of quantitative information for recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C)

BC24O The boards understood that recognised financial instruments included in the disclosure requirements in paragraph 13C of IFRS 7 may be subject to different measurement requirements. For example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative asset or derivative liability subject to the same disclosure requirements (for example, in paragraph 13C(a) of IFRS 7) will be measured at fair value. In addition, the fair value amount of any financial instrument collateral received or pledged and subject to paragraph 13C(d)(ii) of IFRS 7 should be included in the disclosures to provide users of financial statements with the best information about an entity's exposure. Consequently, a financial asset or financial liability disclosure table may include financial instruments measured at different amounts. To provide users of financial statements with the information they need to evaluate the amounts disclosed in accordance with paragraph 13C of IFRS 7, the boards decided that an entity should describe any resulting measurement differences in the related disclosures.

Disclosure of the net amounts presented in the statement of financial position (paragraph 13C(c))

BC24P When providing feedback on the proposals in the exposure draft, users of financial statements emphasised that information in the notes should be clearly reconciled back to the amounts in the statement of financial position. The boards therefore decided that if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information when disclosing amounts in accordance with paragraph 13C of IFRS 7, the entity must still reconcile the amounts disclosed in paragraph 13C(c) of IFRS 7 back to the individual line item amounts in the statement of financial position.

Disclosure of the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) (paragraph 13C(d))

BC24Q Paragraph 13C(d)(i) of IFRS 7 requires disclosure of amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of IAS 32. This may include current rights of set-off that do not meet the criterion in paragraph 42(b) of IAS 32, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties. Although such rights do not qualify for set-off in accordance with IAS 32, users of financial statements are interested in arrangements that an entity has entered into that mitigate the entity's exposure to such financial instruments in the normal course of business and/or in the events of default and insolvency or bankruptcy.

BC24R Paragraph 13C(d)(ii) of IFRS 7 requires disclosure of amounts of cash and financial instrument collateral (whether recognised or unrecognised) that do not meet the criteria for offsetting in the statement of financial position but that relate to financial instruments within the scope of these disclosure requirements. Depending on the terms of the collateral arrangement, collateral will often reduce an entity's exposure in the events of default and insolvency or bankruptcy of a counterparty to the contract. Collateral received or pledged against financial assets and financial liabilities may often be liquidated immediately upon an event of default. Consequently, the boards concluded that the amounts of collateral that are not set off in the statement of financial position but that are associated with other netting arrangements should be included in the amounts disclosed as required by paragraph 13C(d)(ii) of IFRS 7.

Limits on the amounts disclosed in paragraph 13C(d) (paragraph 13D)

BC24S The boards concluded that an aggregate disclosure of the amount of cash collateral and/or the fair value of collateral in the form of other financial instruments would be misleading when some financial assets and financial liabilities are over-collateralised and others have insufficient collateral. To prevent an entity from inappropriately obscuring under-collateralised financial instruments with others that are over-collateralised, paragraph 13D of IFRS 7 restricts the amounts of cash and/or financial instrument collateral to be disclosed in respect of a recognised financial instrument to more accurately reflect an entity's exposure. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 13D of IFRS 7. At no point in time should under-collateralisation be obscured.

Disclosure by type of financial instrument or by counterparty

BC24T The exposure draft proposed disclosures by class of financial instrument. An entity would have been required to group financial assets and financial liabilities separately into classes that were appropriate to the nature of the information disclosed, taking into account the characteristics of those financial instruments and the applicable rights of set-off. Many preparers were concerned that the cost of disclosing amounts related to rights of set-off in the events of default and insolvency or bankruptcy by class of financial instrument would outweigh the benefit. They also indicated that they often manage credit exposure by counterparty and not necessarily by class of financial instrument.

BC24U Many users of financial statements indicated that disclosure of recognised amounts subject to enforceable master netting arrangements and similar agreements (including financial collateral) that were not set off in the statement of financial position would be useful irrespective of whether the amounts are disclosed by counterparty or by type or by class of financial instrument, as long as they can reconcile these amounts back to the statement of financial position. In evaluating whether the disclosures should be provided by type or by class of financial instrument or by counterparty, the boards noted that the objective of these disclosures (paragraph 13B of IFRS 7) is that an entity should disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position.

BC24V The boards decided to reduce the burden on preparers by requiring disclosure by type of financial instrument rather than by class. Disclosure by type of financial instrument may (or may not) differ from the class of financial instrument used for other disclosures in IFRS 7, but is appropriate in circumstances where a difference would better achieve the objective of the disclosures required by these amendments. The boards also decided to provide flexibility as to whether the information required by paragraph 13C(c)–(e) of IFRS 7 is presented by type of financial instrument or by counterparty. This would allow preparers to present the disclosures in the same way that they manage their credit exposure.

BC24W The Board also noted that paragraph 31 of IFRS 7 requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period. In addition, paragraph 34 of IFRS 7 requires the disclosure of concentrations of risk for each type of risk. Consequently, the Board noted that, irrespective of whether the disclosures were required to be provided by type or by class of financial instrument or by counterparty, entities are already required to disclose information about risks and how they are managed, including information about concentrations of credit risk.

Other considerations

Reconciliation between IFRSs and US GAAP

BC24X Some users of financial statements asked for information to help them reconcile between the amounts set off in accordance with IFRSs and the amounts set off in accordance with US GAAP. The boards recognised that the amounts disclosed in accordance with paragraph 13C(b), (c) and (d) of IFRS 7 will probably be different for financial statements prepared in accordance with IFRSs and those prepared in accordance with US GAAP. However, the amounts disclosed in accordance with paragraph 13C(a) and (e) of IFRS 7 are generally not affected by the offsetting criteria applied in the statement of financial position. These amounts are important for users of financial statements to understand the effects of netting arrangements on an entity's financial position in the normal course of business and in the events of default and insolvency or bankruptcy.

BC24Y Consequently, while the amended disclosure requirements do not directly reconcile the IFRS and US GAAP amounts, they provide both gross and net information on a comparable basis. The boards considered that requiring a full reconciliation between IFRSs and US GAAP was unnecessary, particularly given the relative costs and benefits. Such reconciliation would have required preparers to apply two sets of accounting requirements and to track any changes to the related accounting standards and to contracts in the related jurisdictions.

Tabular information

BC24Z The disclosures require amounts to be presented in a tabular format (ie a table) unless another format is more appropriate. The boards believe that a tabular format best conveys an overall understanding of the effect of any rights of set-off and other related arrangements on an entity's financial position and improves the transparency of such information.

Transition and effective date

BC24AA The boards identified two transition approaches in the exposure draft—prospective and retrospective.

BC24AB Prospective transition is generally appropriate only in situations where it is not practicable to apply a standard to all prior periods. The boards did not believe that this was the case with the proposed disclosure requirements. Retrospective transition would require an entity to apply the new requirements to all periods presented. This would maximise consistency of financial information between periods. Retrospective transition would enable analysis and understanding of comparative accounting information among entities. In addition, the scope of the disclosures was reduced and the disclosures amended to require less detailed information than originally proposed, which would make them less burdensome for preparers to apply retrospectively.

BC24AC The exposure draft did not propose an effective date, but instead asked respondents for information about the time and effort that would be involved in implementing the proposed requirements. The boards indicated that they would use such feedback, as well as the responses in their *Request for Views on Effective Dates and Transition Methods*, and the timing of other planned accounting and reporting standards, to determine an appropriate effective date for the proposals in the exposure draft.

BC24AD Some respondents suggested that the offsetting proposals should have the same effective date as the other components of the IASB's project to replace IAS 39 with IFRS 9 *Financial Instruments*. If an earlier date was required, it was suggested that application should be restricted only to the accounting period being presented, rather than providing comparative information, because of the potential burden of applying the proposed disclosure requirements.

BC24AE At the time the amended disclosure requirements were issued (December 2011), IFRS 9 was not yet mandatorily effective. However, the Board did not believe that the IFRS 9 project would change the offsetting disclosures. Aligning the effective date of these amendments with the effective date of the financial instruments project could result in postponing the effective date of the common disclosure requirements, which would mean a delay in providing users of financial statements the information that they need. For users of financial statements to benefit from the increased comparability, and because the offsetting and IFRS 9 projects are independent of one another, the boards decided that common disclosures should be effective as early as possible.

BC24AF In addition, the boards did not think that a long transition period was needed, because the amended disclosures had a reduced scope and less detailed information than originally proposed in the exposure draft and were related to the presentation of instruments that entities have already recognised and measured. The boards therefore decided that the effective date for the amended disclosures should be for annual periods beginning on or after 1 January 2013, and interim periods within those annual periods.

BC24AG As described in greater detail in other sections of this Basis for Conclusions, the disclosures required by paragraphs 13B–13E of IFRS 7 are a result of requests from users of financial statements for information to enable them to compare statements of financial position prepared in accordance with IFRSs with statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.

BC24AH The information required in paragraphs 13B–13E of IFRS 7 will enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position for financial statements presented in accordance with IFRSs and those presented in accordance with US GAAP.

BC24AI The Board noted that paragraph 10(f) of IAS 1 *Presentation of Financial Statements* requires an entity to provide a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. In the case of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), because the change relates only to disclosures and there is no associated change in accounting policy, or a resulting restatement or reclassification, it was noted that paragraph 10(f) of IAS 1 does not apply for these amendments to IFRS 7.

Cost-benefit considerations

BC24AJ Before issuing an IFRS or an amendment to an IFRS, the Board seeks to ensure that it will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. As described in greater detail in other sections of this Basis for Conclusions on *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), the Board considered that there is significant benefit to market participants in providing these disclosures. The disclosures address a significant difference between the amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. The disclosures therefore make the amounts presented in accordance with both sets of standards more comparable.

BC24AK During redeliberations, the Board considered feedback related to the costs of providing the disclosures proposed in the exposure draft. As described in greater detail in other sections of this Basis for Conclusions, the Board decided to limit the scope of the disclosures because these changes would reduce the cost to preparers while still providing the information that users of financial statements had requested.

BC24AL On the basis of the considerations described in the Basis for Conclusions on these amendments, and summarised in paragraphs BC24AJ and BC24AK, the Board concluded that the benefits of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) outweigh the costs to preparers of applying these amendments.

Collateral (paragraphs 14 and 15)

BC25 Paragraph 15 requires disclosures about collateral that the entity holds if it is permitted to sell or repledge the collateral in the absence of default by the owner. Some respondents to ED 7 argued for an exemption from this disclosure if it is impracticable to obtain the fair value of the collateral held. However, the Board concluded that it is reasonable to expect an entity to know the fair value of collateral that it holds and can sell even if there is no default.

Allowance account for credit losses (paragraph 16)

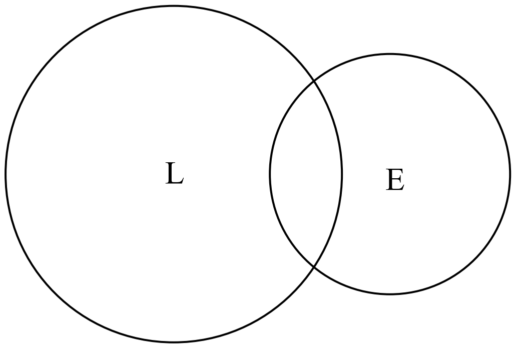
BC26 When a separate account is used to record impairment losses (such as an allowance account or similar account used to record a collective impairment of assets), paragraph 16 requires a reconciliation of that account to be disclosed. The Board was informed that analysts and other users find this information useful in assessing the adequacy of the allowance for impairment losses for such entities and when comparing one entity with another. However, the Board decided not to specify the components of the reconciliation. This allows entities flexibility in determining the most appropriate format for their needs.

BC27 Respondents to ED 7 asked the Board to require entities to provide equivalent information if they do not use an allowance account. The Board decided not to add this disclosure in finalising the IFRS. It concluded that, for virtually all entities, IAS 39's requirement to consider impairment on a group basis would necessitate the use of an allowance or similar account. The accounting policy disclosures required by paragraph B5(d) also include information about the use of direct adjustments to carrying amounts of financial assets.

Compound financial instruments with multiple embedded derivatives (paragraph 17)

BC28 IAS 32 requires the separation of the liability and equity components of a compound financial instrument. The Board notes that this is more complicated for compound financial instruments with multiple embedded derivative features whose values are interdependent (for example, a convertible debt instrument that gives the issuer a right to call the instrument back from the holder, or the holder a right to put the instrument back to the issuer) than for those without such features. If the embedded equity and non-equity derivative features are interdependent, the sum of the separately determined values of the liability and equity components will not equal the value of the compound financial instrument as a whole.

BC29 For example, the values of an embedded call option feature and an equity conversion option feature in a callable convertible debt instrument depend in part on each other if the holder's equity conversion option is extinguished when the entity exercises the call option or vice versa. The following diagram illustrates the joint value arising from the interaction between a call option and an equity conversion option in a callable convertible bond. Circle L represents the value of the liability component, ie the value of the straight debt and the embedded call option on the straight debt, and Circle E represents the value of the equity component, ie the equity conversion option on the straight debt. The total area of the two circles represents the value of the callable convertible bond. The difference between the value of the callable convertible bond as a whole and the sum of the separately determined values for the liability and equity components is the joint value attributable to the interdependence between the call option feature and the equity conversion feature. It is represented by the intersection between the two circles.



BC30 Under the approach in IAS 32, the joint value attributable to the interdependence between multiple embedded derivative features is included in the liability component. A numerical example is set out as Illustrative Example 10 accompanying IAS 32.

BC31 Even though this approach is consistent with the definition of equity as a residual interest, the Board recognises that the allocation of the joint value to either the liability component or the equity component is arbitrary because it is, by its nature, joint. Therefore, the Board concluded that it is important to disclose the existence of issued compound financial instruments with multiple embedded derivative features that have interdependent values. Such disclosure highlights the effect of multiple embedded derivative features on the amounts recognised as liabilities and equity.

Defaults and breaches (paragraphs 18 and 19)

BC32 Paragraphs 18 and 19 require disclosures about defaults and breaches of loans payable and other loan agreements. The Board concluded that such disclosures provide relevant information about the entity's creditworthiness and its prospects of obtaining future loans.

Income statement and equity (paragraph 20)

Items of income, expenses, gains or losses (paragraph 20(a))

BC33 Paragraph 20(a) requires disclosure of income statement gains and losses by the measurement classifications in IAS 39 (which complement the balance sheet disclosure requirement described in paragraph BC14). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IAS 39.

BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities held for trading and others do not. To assist users in comparing income arising from financial instruments across different entities, the Board decided that an entity should disclose how the income statement amounts are determined. For example, an entity should disclose whether net gains and losses on financial assets or financial liabilities held for trading include interest and dividend income (see Appendix B, paragraph B5(e)).

Fee income and expense (paragraph 20(c))

BC35 Paragraph 20(c) requires disclosure of fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities and from trust and other fiduciary activities that result in the entity holding or placing assets on behalf of individuals, trusts, retirement benefit plans, and other institutions. This information indicates the level of such activities and helps users to estimate possible future income of the entity.

Other disclosures—fair value (paragraphs 25-30)[1]

BC36 Many entities use fair value information internally in determining their overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgement of the financial markets about the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of why they are held and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. The Board decided that when an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it should provide fair value information through supplementary disclosures to assist users to compare entities on a consistent basis.

BC37 Disclosure of fair value is not required for investments in unquoted equity instruments[2] and derivatives linked to such equity instruments if their fair value cannot be measured reliably. Similarly, IFRS 4 does not specify the accounting required for contracts containing a discretionary participation feature pending phase II of the Board's project on insurance contracts. Accordingly, disclosure of fair value is not required for contracts containing a discretionary participation feature, if the fair value of that feature cannot be measured reliably. For all other financial assets and financial liabilities, it is reasonable to expect that fair value can be determined with sufficient reliability within constraints of timeliness and cost. Therefore, the Board concluded that there should be no other exception from the requirement to disclose fair value information for financial assets or financial liabilities.

BC38 To provide users of financial statements with a sense of the potential variability of fair value estimates, the Board decided that information about the use of valuation techniques should be disclosed, in particular the sensitivities of fair value estimates to the main valuation assumptions.[3] In forming this conclusion, the Board considered the view that disclosure of sensitivities could be difficult, particularly when there are many assumptions to which the disclosure would apply and these assumptions are interdependent. However, the Board noted that a detailed quantitative disclosure of sensitivity to all assumptions is not required (only those that could result in a significantly different estimate of fair value are required) and that the disclosure does not require the entity to reflect interdependencies between assumptions when making the disclosure. Additionally, the Board considered whether this disclosure might imply that a fair value established by a valuation technique is less reliable than one established by other means. However, the Board noted that fair values estimated by valuation techniques are more subjective than those established from an observable market price, and concluded that users need information to help them assess the extent of this subjectivity.

[1] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence paragraphs 27-27B of IFRS 7 have been deleted.

[2] IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 and IFRS 9 refer to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

[3] IFRS 13, issued in May 2011, resulted in paragraph 27B(c) of IFRS 7 being deleted.

BC39 Paragraph 28 requires disclosure about the difference that arises if the transaction price differs from the fair value of a financial instrument that is determined in accordance with paragraph AG76 of IAS 39. Those disclosures relate to matters addressed in the December 2004 amendment to IAS 39 *Transition and Initial Recognition of Financial Assets and Financial Liabilities*. That amendment does not specify how entities should account for those initial differences in subsequent periods. The disclosures required by paragraph 28 inform users about the amount of gain or loss that will be recognised in profit or loss in future periods. The Board noted that the information required to provide these disclosures would be readily available to the entities affected.

BC39A Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) issued by the US Financial Accounting Standards Board requires disclosures that are based on a three-level fair value hierarchy for the inputs used in valuation techniques to measure fair value. The Board was asked by some users of financial statements to include similar disclosure requirements in IFRS 7 to provide more information about the relative reliability of the inputs to fair value measurements. The Board concluded that such a hierarchy would improve comparability between entities about the effects of fair value measurements as well as increase the convergence of IFRSs and US generally accepted accounting principles (GAAP). Therefore, the Board decided to require disclosures for financial instruments on the basis of a fair value hierarchy.[4]

BC39B Because its own fair value measurement project was not yet completed, the Board decided not to propose a fair value hierarchy for measurement, but only for disclosures. The fair value hierarchy for disclosures is the same as that in SFAS 157 but uses IFRS language pending completion of the fair value measurement project. Although the implicit fair value hierarchy for measurement in IAS 39 is different from the fair value hierarchy in SFAS 157, the Board recognised the importance of using a three-level hierarchy for disclosures that is the same as that in SFAS 157.[5]

BC39C The Board noted the following three-level measurement hierarchy implicit in IAS 39:

(a) financial instruments quoted in an active market;

(b) financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets; and

(c) financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument (ie without modification or repackaging) and not based on available observable market data.

BC39D For example, the Board acknowledged that some financial instruments that for measurement purposes are considered to have an active market in accordance with paragraphs AG71–AG73 of IAS 39 might be in Level 2 for disclosure purposes. Also, the application of paragraph AG76A of IAS 39 might result in no gain or loss being recognised on the initial recognition of a financial instrument that is in Level 2 for disclosure purposes.[6]

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4 IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures.

5 IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures. That hierarchy is identical to the hierarchy in Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*®, which codified SFAS 157.

6 IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a result paragraphs AG71-AG73 and paragraph AG76A of IAS 39 have been deleted. In addition, the requirements in paragraph AG76A have been relocated to paragraph AG76(b).

BC39E The introduction of the fair value disclosure hierarchy does not affect any measurement or recognition requirements of other standards. In particular, the Board noted that the recognition of gains or losses at inception of a financial instrument (as required by paragraph AG76 of IAS 39) would not change as a result of the fair value disclosure hierarchy.

BC39F The Board decided to require additional disclosures for instruments with fair value measurements that are in Level 3 of the fair value hierarchy.[7] These disclosures inform users of financial statements about the effects of those fair value measurements that use the most subjective inputs.

BC39G After reviewing comments received on the exposure draft, the Board decided not to require disclosure by level of the fair value hierarchy for financial instruments that are not measured at fair value in the statement of financial position. The Board noted that paragraphs 25 and 27 of IFRS 7, which require the disclosure of the fair value of each class of assets and liabilities in a way that permits it to be compared with its carrying amount, and the methods and assumptions applied in determining fair values, were retained.[8]

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[7] IFRS 13, issued in May 2011, requires disclosures about fair value measurements. As a consequence paragraphs 27-27B of IFRS 7 have been deleted.

[8] IFRS 13, issued in May 2011, resulted in paragraph 27 of IFRS 7 being deleted.

Disclosures about the nature and extent of risks arising from financial instruments (paragraphs 31-42 and B6-B28)

BC40 The Board was informed that users of financial statements value information about the risks arising from financial instruments, such as credit risk, liquidity risk and market risk, to which entities are exposed, and the techniques used to identify, measure, monitor and control those risks. Therefore, the Board decided to require disclosure of this information. The Board also decided to balance two objectives:

(a) consistent requirements should apply to all entities so that users receive comparable information about the risks to which entities are exposed.

(b) the disclosures provided should depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks. Entities with many financial instruments and related risks should provide more disclosure to communicate those risks to users of financial statements. Conversely, entities with few financial instruments and related risks may provide less extensive disclosure.

BC41 The Board decided to balance these two objectives by developing an IFRS that sets out principles and minimum requirements applicable to all entities, supported by guidance on implementing the IFRS. The requirements in paragraphs 33-42 combine qualitative disclosures of the entity's exposure to risks arising from financial instruments, and the way in which management views and manages these risks, with quantitative disclosures about material risks arising from financial instruments. The extent of disclosure depends on the extent of the entity's exposure to risks arising from financial instruments. The guidance on implementing the IFRS illustrates how an entity might apply the IFRS. This guidance is consistent with the disclosure requirements for banks developed by the Basel Committee (known as Pillar 3), so that banks can prepare, and users receive, a single co-ordinated set of disclosures about financial risk.

BC42 The Board noted that because entities view and manage risk in different ways, disclosures based on how an entity manages risk are unlikely to be comparable between entities. In addition, for an entity that undertakes limited management of risks arising from financial instruments, such disclosures would convey little or no information about the risks the entity has assumed. To overcome these limitations, the Board decided to specify disclosures about risk exposures applicable to all entities. These disclosures provide a common benchmark for financial statement users when comparing risk exposures across different entities and are expected to be relatively easy for entities to prepare. Entities with more developed risk management systems would provide more detailed information.

Interaction between qualitative and quantitative disclosures (paragraph 32A)

BC42A In *Improvements to IFRSs* issued in May 2010, the Board addressed a perceived lack of clarity in the intended interaction between the qualitative and quantitative disclosures of the nature and extent of risks arising from financial instruments. The Board emphasised the interaction between qualitative and quantitative disclosures about the nature and extent of risks arising from financial instruments. This enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The Board concluded that an explicit emphasis on the interaction between qualitative and quantitative disclosures will contribute to disclosure of information in a way that better enables users to evaluate an entity's exposure.

Location of disclosures of risks arising from financial instruments (paragraph B6)

BC43 Many respondents to ED 7 argued that disclosures about risks in paragraphs 31-42 should not be part of the financial statements for the following reasons:

(a) the information would be difficult and costly to audit.

(b) the information is different from information generally included in financial statements because it is subjective, forward-looking and based on management's judgement. Thus, the information does not meet the criteria of comparability, faithful representation and completeness.

(c) inclusion of such information in a management commentary section outside the financial statements would be consistent with practice in other jurisdictions, including the US. Having this information in the financial statements would put IFRS preparers at a disadvantage relative to their US peers.

BC44 Respondents raised concerns that the disclosure of sensitivity analysis in particular should not be part of the financial statements. Respondents stated that sensitivity analysis cannot be prepared with the degree of reliability expected of information in the financial statements, and that the subjectivity in the sensitivity analysis and the hypothetical alternative values could undermine the credibility of the fair values recognised in the financial statements.

BC45 The Board considered whether the disclosures should be part of the information provided by management outside the financial statements. The Board noted that respondents generally regarded the disclosures proposed in ED 7 as useful, even if they did not agree that they should be located in the financial statements. The Board's view is that financial statements would be incomplete and potentially misleading without disclosures about risks arising from financial instruments. Hence, it concluded that such disclosures should be part of the financial statements. The Board rejected the argument that increased transparency puts an entity at a disadvantage; greater certainty on the part of investors can provide a significant advantage by lowering the entity's cost of capital.

BC46 The Board also noted that some entities might prefer to present the information required by the IFRS together with material such as a management commentary or risk report that is not part of the financial statements. Some entities might be required by regulatory authorities to provide in a separate report information similar to that required by the IFRS. Accordingly, the Board decided these disclosures should be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time.

Quantitative disclosures (paragraphs 34-42 and B7-B28)

Information based on how the entity manages risk (paragraphs 34 and B7)

BC47 The Board concluded that disclosures about an entity's exposure to risks arising from financial instruments should be required, and should be based on how the entity views and manages its risks, ie using the information provided to key management personnel (for example, its board of directors or chief executive officer). This approach:

(a) provides a useful insight into how the entity views and manages risk;

(b) results in information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the entity's ability to react to adverse situations;

(c) is more effective in adapting to changes in risk measurement and management techniques and developments in the external environment;

(d) has practical advantages for preparers of financial statements, because it allows them to use the data they use in managing risk; and

(e) is consistent with the approach used in IAS 14 *Segment Reporting.*[*]

BC47A In *Improvements to IFRSs* issued in May 2010, the Board removed the reference to materiality from paragraph 34(b) of IFRS 7. The Board noted that the reference could imply that disclosures in IFRS 7 are required even if those disclosures are not material, which was not the Board's intention.

Information on averages

BC48 The Board considered whether it should require quantitative information about average risk exposures during the period. It noted that information about averages is more informative if the risk exposure at the reporting date is not typical of the exposure during the period. However, information about averages is also more onerous to prepare. On balance, the Board decided to require disclosure of the exposures at the reporting date in all cases and to require additional information only if the information provided at the reporting date is unrepresentative of the entity's exposure to risk during the period.

Credit risk (paragraphs 36-38, B9 and B10)

Maximum exposure to credit risk (paragraphs 36(a), B9 and B10)

BC49 Paragraph 36(a) requires disclosure of an entity's maximum exposure to credit risk at the reporting date. Some respondents to ED 7 stated that these disclosures would not provide useful information when there are no identified problems in a loan portfolio, and it is not likely that collateral would be called on. However, the Board disagreed because it believes that such information:

(a) provides users of financial statements with a consistent measure of an entity's exposure to credit risk; and

(b) takes into account the possibility that the maximum exposure to loss may differ from the amount recognised in the balance sheet.

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

BC49A In *Improvements to IFRSs* issued in May 2010, the Board enhanced consistency within IFRS 7 by clarifying that the disclosure requirement in paragraph 36(a) applies only to financial assets whose carrying amounts do not show the reporting entity's maximum exposure to credit risk. Such an approach is consistent with the approach taken in paragraph 29(a), which states that disclosure of fair value is not required when the carrying amount is a reasonable approximation of fair value. Moreover, the Board concluded that the requirement might be duplicative for assets that are presented in the statement of financial position because the carrying amount of these assets often represents the maximum exposure to credit risk. In the Board's view, the disclosure requirement should focus on the entity's exposure to credit risk that is not already reflected in the statement of financial position.

BC50 Some respondents to ED 7 questioned whether the maximum exposure to credit risk for a derivative contract is its carrying amount because fair value does not always reflect potential future exposure to credit risk (see paragraph B10(b)). However, the Board noted that paragraph 36(a) requires disclosure of the amount that best represents the maximum exposure to credit risk *at the reporting date*, which is the carrying amount.

Collateral held as security and other credit enhancements (paragraphs 36(b) and 37(c))

BC51 ED 7 proposed that, unless impracticable, the entity should disclose the fair value of collateral held as security and other credit enhancements, to provide information about the loss the entity might incur in the event of default. However, many respondents to ED 7 disagreed with this proposal on cost/benefit grounds. Respondents indicated that fair value information might not be available for:

(a) small entities and entities other than banks, which may find it onerous to acquire information about collateral;

(b) banks that collect precise information on the value of collateral only on origination, for loans whose payments are made on time and in full (for example a mortgage portfolio secured by properties, for which valuations are not kept up to date on an asset-by-asset basis);

(c) particular types of collateral, such as a floating charge on all the assets of an entity; and

(d) insurers that hold collateral for which fair value information is not readily available.

BC52 The Board also noted respondents' concerns that an aggregate disclosure of the fair value of collateral held would be misleading when some loans in a portfolio are over-collateralised, and other loans have insufficient collateral. In these circumstances, netting the fair value of the two types of collateral would under-report the amount of credit risk. The Board agreed with respondents that the information useful to users is not the total amount of credit exposure less the total amount of collateral, but rather is the amount of credit exposure that is left after available collateral is taken into account.

BC53 Therefore, the Board decided not to require disclosure of the fair value of collateral held, but to require disclosure of only a description of collateral held as security and other credit enhancements. The Board noted that such disclosure does not require an entity to establish fair values for all its collateral (in particular when the entity has determined that the fair value of some collateral exceeds the carrying amount of the loan) and, thus, would be less onerous for entities to provide than fair values.

Credit quality of financial assets that are neither past due nor impaired (paragraph 36(c))

BC54 The Board noted that information about credit quality gives a greater insight into the credit risk of assets and helps users assess whether such assets are more or less likely to become impaired in the future. Because this information will vary between entities, the Board decided not to specify a particular method for giving this information, but rather to allow each entity to devise a method that is appropriate to its circumstances.

Financial assets with renegotiated terms (paragraph 36(d))

BC54A In *Improvements to IFRSs* issued in May 2010, the Board addressed a practical concern relating to the disclosure requirements for renegotiated financial assets. The Board deleted the requirement in paragraph 36(d) to disclose the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated. The Board considered the difficulty in identifying financial assets whose terms have been renegotiated to avoid becoming past due or impaired (rather than for other commercial reasons). The Board noted that the original requirement was unclear about whether the requirement applies only to financial assets that were renegotiated in the current reporting period or whether past negotiations of those assets should be considered. Moreover, the Board was informed that commercial terms of loans are often renegotiated regularly for reasons that are not related to impairment. In practice it is difficult, especially for a large portfolio of loans, to ascertain which loans were renegotiated to avoid becoming past due or impaired.

Financial assets that are either past due or impaired (paragraph 37)

BC55 The Board decided to require separate disclosure of financial assets that are past due or impaired to provide users with information about financial assets with the greatest credit risk (paragraph 37). This includes:

(a) an analysis of the age of financial assets, including trade receivables, that are past due at the reporting date, but not impaired (paragraph 37(a)). This information provides users with information about those financial assets that are more likely to become impaired and helps users to estimate the level of future impairment losses.

(b) an analysis of financial assets that are individually determined to be impaired at the reporting date, including the factors the entity considered in determining that the financial assets are impaired (paragraph 37(b)). The Board concluded that an analysis of impaired financial assets by factors other than age (eg nature of the counterparty, or geographical analysis of impaired assets) would be useful because it helps users to understand why the impairment occurred.

BC55A In *Improvements to IFRSs* issued in May 2010, the Board addressed a concern that the disclosure of the fair value of collateral was potentially misleading. Within a class of assets some might be over-collateralised while others might be under-collateralised. Hence, aggregate disclosure of the fair value might be misleading. Therefore, the Board removed from paragraph 37(c) the requirement to disclose the fair value of collateral and other credit enhancements. However, the Board believes that information on the financial effect of such assets is useful to users. Hence, the Board included in paragraph 36(b) a requirement to disclose a description of collateral held as security and of other credit enhancements and to disclose their financial effect.

Collateral and other credit enhancements obtained (paragraph 38)

BC56 Paragraph 38 requires the entity to disclose the nature and carrying amount of assets obtained by taking possession of collateral held as security or calling on other credit enhancements and its policy for disposing of such assets. The Board concluded that this information is useful because it provides information about the frequency of such activities and the entity's ability to obtain and realise the value of the collateral. ED 7 had proposed that the entity should disclose the fair value of the assets obtained less the cost of selling them, rather than the carrying amount. The Board noted that this amount might be more relevant in the case of collateral obtained that is expected to be sold. However, it also noted that such an amount would be included in the impairment calculation that is reflected in the amount recognised in the balance sheet and the purpose of the disclosure is to indicate the amount recognised in the balance sheet for such assets.

BC56A In *Improvements to IFRSs* issued in May 2010, the Board enhanced consistency within IFRS 7 by clarifying that paragraph 38 requires entities to disclose the amount of foreclosed collateral held at the reporting date. This is consistent with the objective in IFRS 7 to disclose information that enables users to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

Liquidity risk (paragraphs 34(a), 39, B10A and B11A-B11F)

BC57 The Board decided to require disclosure of a maturity analysis for financial liabilities showing the remaining earliest contractual maturities (paragraph 39(a) and paragraphs B11-B16 of Appendix B[*]). Liquidity risk, ie the risk that the entity will encounter difficulty in meeting commitments associated with financial liabilities, arises because of the possibility (which may often be remote) that the entity could be required to pay its liabilities earlier than expected. The Board decided to require disclosure based on the earliest contractual maturity date because this disclosure shows a worst case scenario.

BC58 Some respondents expressed concerns that such a contractual maturity analysis does not reveal the expected maturity of liabilities, which, for some entities—eg banks with many demand deposits—may be very different. They suggested that a contractual maturity analysis alone does not provide information about the conditions expected in normal circumstances or how the entity manages deviations from expected maturity. Therefore, the Board decided to require a description of how the entity manages the liquidity risk portrayed by the contractual maturity analysis.

BC58A In March 2009 the Board amended the disclosure requirements on the nature and extent of liquidity risk by:

(a) amending the definition of liquidity risk to clarify that paragraph 39 applies only to financial liabilities that will result in the outflow of cash or another financial asset. This clarifies that the disclosure requirements would not apply to financial liabilities that will be settled in the entity's own equity instruments and to liabilities within the scope of IFRS 7 that are settled with non-financial assets.

(b) emphasising that an entity must provide summary quantitative data about its exposure to liquidity risk based on information provided internally to key management personnel of the entity as required by paragraph 34(a). This reinforces the principles of IFRS 7.

(c) amending the requirement in paragraph 39 to disclose a contractual maturity analysis.

[*] Amendments to IFRS 7 issued in March 2009 amended paragraph 39 and paragraphs B11-B16. The paragraph references in paragraph BC57 have not been amended as a result of these amendments.

BC58B The requirements in paragraph 39(a) and (b) relate to minimum benchmark disclosures as set out in paragraph 34(b) and are expected to be relatively easy to apply. However, the Board noted that the requirement to provide disclosures based on the remaining contractual maturities was difficult to apply for some derivative financial liabilities and did not always result in information that reflects how many entities manage liquidity risk for such instruments. Hence, for some circumstances the Board eliminated the previous requirement to disclose contractual maturity information for derivative financial liabilities. However, the Board retained minimum contractual maturity disclosures for non-derivative financial liabilities (including issued financial guarantee contracts within the scope of the IFRS) and for some derivative financial liabilities.

BC58C The Board noted that for non-derivative financial liabilities (including issued financial guarantee contracts within the scope of the IFRS) and some derivative financial liabilities, contractual maturities are essential for an understanding of the timing of cash flows associated with the liabilities. Therefore, this information is useful to users of financial statements. The Board concluded that disclosures based on the remaining contractual maturities of these financial liabilities should continue to be required.

BC58D The Board also emphasised the existing requirement to disclose a maturity analysis for financial assets held for managing liquidity risk, if that information is required to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The Board also emphasised that an entity must explain the relationship between qualitative and quantitative disclosures about liquidity risk so that users of financial statements can evaluate the nature and extent of liquidity risk.

Market risk (paragraphs 40-42 and B17-B28)

BC59 The Board decided to require disclosure of a sensitivity analysis for each type of market risk (paragraph 40) because:

(a) users have consistently emphasised the fundamental importance of sensitivity analysis;

(b) a sensitivity analysis can be disclosed for all types of market risk and by all entities, and is relatively easy to understand and calculate; and

(c) it is suitable for all entities—including non-financial entities—that have financial instruments. It is supported by disclosures of how the entity manages the risk. Thus, it is a simpler and more suitable disclosure than other approaches, including the disclosures of terms and conditions and the gap analysis of interest rate risk previously required by IAS 32.

The Board noted that information provided by a simple sensitivity analysis would not be comparable across entities. This is because the methodologies used to prepare the sensitivity analysis and the resulting disclosures would vary according to the nature of the entity and the complexity of its risk management systems.

BC60 The Board acknowledged that a simple sensitivity analysis that shows a change in only one variable has limitations. For example, the analysis may not reveal non-linearities in sensitivities or the effects of interdependencies between variables. The Board decided to meet the first concern by requiring additional disclosure when the sensitivity analysis is unrepresentative of a risk inherent in a financial instrument (paragraph 42). The Board noted that it could meet the second concern by requiring a more complex sensitivity analysis that takes into account the interdependencies between risks. Although more informative, such an analysis is also more complex and costly to prepare. Accordingly, the Board decided not to require such an analysis, but to permit its disclosure as an alternative to the minimum requirement when it is used by management to manage risk.

BC61 Respondents to ED 7 noted that a value-at-risk amount would not show the effect on profit or loss or equity. However, entities that manage on the basis of value at risk would not want to prepare a separate sensitivity analysis solely for the purpose of this disclosure. The Board's objective was to require disclosures about sensitivity, not to mandate a particular form of sensitivity disclosure. Therefore, the Board decided not to require disclosure of the effects on profit or loss and equity if an alternative disclosure of sensitivity is made.

BC62 Respondents to ED 7 requested the Board to provide more guidance and clarification about the sensitivity analysis, in particular:

(a) what is a reasonably possible change in the relevant risk variable?

(b) what is the appropriate level of aggregation in the disclosures?

(c) what methodology should be used in preparing the sensitivity analysis?

BC63 The Board concluded that it would not be possible to provide comprehensive guidance on the methodology to be used in preparing the sensitivity analysis. The Board noted that more comparable information would be obtained if it imposed specific requirements about the inputs, process and methodology of the analysis, for example disclosure of the effects of a parallel shift of the yield curve by 100 basis points. However, the Board decided against such a specific requirement because a reasonably possible change in a relevant risk variable (such as interest rates) in one economic environment may not be reasonably possible in another (such as an economy with higher inflation). Moreover, the effect of a reasonably possible change will vary depending on the entity's risk exposures. As a result, entities are required to judge what those reasonably possible changes are.

BC64 However, the Board decided that it would provide high level application guidance about how the entity should assess what is a reasonably possible change and on the appropriate level of aggregation in the disclosures. In response to comments received on ED 7, the Board also decided to clarify that:

(a) an entity should not aggregate information about material exposures to risk from significantly different economic environments. However, if it has exposure to only one type of market risk in only one economic environment, it might not show disaggregated information.

(b) the sensitivity analysis does not require entities to determine what the profit or loss for the period would have been had the relevant risk variable been different. The sensitivity analysis shows the effect on current period profit or loss and equity if a reasonably possible change in the relevant risk variable had been applied to the risk exposures in existence at the balance sheet date.

(c) a reasonably possible change is judged relative to the economic environments in which the entity operates, and does not include remote or "worst case" scenarios or "stress tests".

(d) entities are required to disclose only the effects of the changes at the limits of the reasonably possible range of the relevant risk variable, rather than all reasonably possible changes.

(e) the time frame for which entities should make an assessment about what is reasonably possible is the period until the entity next presents these disclosures, usually its next annual reporting period.

The Board also decided to add a simple example of what a sensitivity analysis might look like.

Operational risk

BC65 The Board discussed whether it should require disclosure of information about operational risk. However, the Board noted that the definition and measurement of operational risk are in their infancy and are not necessarily related to financial instruments. It also decided that such disclosures would be more appropriately located outside the financial statements. Therefore, the Board decided to defer this issue to its research project on management commentary.

Disclosures relating to transfers of financial assets

Background

BC65A In March 2009, in conjunction with the Memorandum of Understanding between the IASB and the US Financial Accounting Standards Board (FASB) to improve and achieve convergence of IFRS and US standards for derecognition, the IASB published an exposure draft to replace the derecognition requirements of IAS 39 and to improve the disclosure requirements in IFRS 7 relating to the transfer of financial assets and liabilities. In response to feedback received on the exposure draft the IASB developed more fully the alternative model described in the exposure draft and the boards discussed the alternative model.

BC65B In May 2010 the boards reconsidered their strategies and plans for the derecognition project in the light of:

(a) their joint discussions of the alternative derecognition model described in the exposure draft;

(b) the June 2009 amendments to the US GAAP derecognition guidance by the FASB, which reduced the differences between IFRSs and US GAAP by improving requirements relating to derecognition of financial assets and liabilities; and

(c) the feedback the IASB received from national standard-setters on the largely favourable effects of the IFRS derecognition requirements during the financial crisis.

BC65C As a result, in June 2010 the IASB and the FASB agreed that their near-term priority was on increasing the transparency and comparability of their standards by improving and aligning the disclosure requirements in IFRSs and US GAAP for financial assets transferred to another entity. The boards also decided to conduct additional research and analysis, including a post-implementation review of some of the FASB's recently amended requirements, as a basis for assessing the nature and direction of any further efforts to improve or align IFRSs and US GAAP.

BC65D As a result, the Board decided to finalise the derecognition disclosures and related objectives, proposed in the exposure draft. Accordingly, in October 2010 the Board issued *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7), requiring disclosures to help users of financial statements:

(a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and

(b) to evaluate the nature of and risks associated with the entity's continuing involvement in derecognised financial assets.

Transferred financial assets that are not derecognised in their entirety

BC65E When financial assets are transferred but not derecognised, there has been an exchange transaction that is not reflected as such in the financial statements as a result of the accounting requirements. The Board concluded that in those situations, users of financial statements need to understand the relationship between those transferred financial assets and the associated liabilities that an entity recognises. Understanding that relationship helps users of financial statements in assessing an entity's cash flow needs and the cash flows available to the entity from its assets.

BC65F The Board observed that IFRS 7 required disclosures about transferred financial assets that are not derecognised in their entirety. The Board decided to continue requiring those disclosures because they provide information that is useful in understanding the relationship between transferred financial assets that are not derecognised and associated liabilities.

BC65G However, the Board also decided that the following additional disclosures were necessary:

(a) a qualitative description of the nature of the relationship between transferred assets and associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets; and

(b) a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position when the counterparty to the associated liabilities has recourse only to the transferred assets.

BC65H The Board concluded that these disclosures would provide information that is useful in assessing the extent to which the economic benefits generated by assets of an entity cannot be used in an unrestricted manner, as is implied when assets are recognised in an entity's statement of financial position. In addition, the disclosures would provide information about liabilities that will be settled entirely from the proceeds received from the transferred assets, and thus identify liabilities for which the counterparties do not have claims on the assets of the entity in general. For those assets for which the underlying cash flows are committed to be used to satisfy related liabilities, the Board noted that a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position (in addition to showing the cash flow relationship between those assets and liabilities) also provides a means of understanding the net exposure of an entity following a transfer transaction that fails derecognition.

Transferred financial assets that are derecognised in their entirety

BC65I The Board was asked by users of financial statements, regulators and others to review the disclosure requirements for what are often described as 'off balance sheet' activities. Transfers of financial assets, particularly securitisation of financial assets, were identified as forming part of such activities.

BC65J The Board concluded that when an entity retains continuing involvement in financial assets that it has derecognised, users of financial statements would benefit from information about the risks to which the entity remains exposed. Such information is relevant in assessing the amount, timing and uncertainty of the entity's future cash flows.

BC65K The Board observed that IFRS 7 already requires certain disclosures by class of financial instrument or by type of risk. However, the IFRS requires the information at an aggregated level, so information specific to derecognition transactions is often not available. In response to requests from users and others the Board concluded that disclosures specific to derecognition transactions were necessary.

BC65L The Board concluded that the disclosures should focus on the risk exposure of an entity, and should provide information about the timing of the return and the cash outflow that would or may be required to repurchase the derecognised financial assets in the future. The Board reasoned that a combination of disclosures about the strike price or repurchase price to repurchase assets, the fair value of its continuing involvement, the maximum exposure to loss and qualitative information about an entity's obligations to provide financial support are relevant in understanding an entity's exposure to risks.

BC65M In addition, the Board concluded that information about an entity's gain or loss on derecognition and the timing of recognition of that gain or loss provides information about the proportion of an entity's profit or loss that arises from transferring financial assets in which the entity also retains continuing involvement. Such information is useful in assessing the extent to which an entity generates profits from transferring financial assets while retaining some form of continuing involvement and thus exposure to risk.

BC65N The Board observed that the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period may not be evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period). The Board decided that if transfer activity is concentrated around the end of reporting periods, disclosure of this fact provides an indication of whether transfer transactions are undertaken for the purpose of altering the appearance of the statement of financial position rather than for an ongoing commercial or financing purpose. In such cases, the amendments require disclosure of when the greatest transfer activity took place within that reporting period, the amount recognised from the transfer activity in that part of the reporting period, and the total amount of proceeds from transfer activity in that part of the reporting period.

Effective date and transition (paragraphs 43 and 44)

BC66 The Board is committed to maintaining a "stable platform" of substantially unchanged Standards for annual periods beginning on or before 1 January 2005, when many entities will adopt IFRSs for the first time. In addition, some preparers will need time to make the system changes necessary to comply with the IFRS. Therefore, the Board decided that the effective date of IFRS 7 should be annual periods beginning on or after 1 January 2007, with earlier application encouraged.

BC67 The Board noted that entities that apply IFRS 7 only when it becomes mandatory will have sufficient time to prepare comparative information. This conclusion does not apply to entities that apply IFRS 7 early. In particular, the time would be extremely short for those entities that would like to apply IFRS 7 when they first adopt IFRSs in 2005, to avoid changing from local GAAP to IAS 32 and IAS 30 when they adopt IFRSs and then changing again to IFRS 7 only one or two years later. Therefore, the Board gave an exemption from providing comparative disclosure in the first year of application of IFRS 7 to any entity that both (a) is a first-time adopter of IFRSs and (b) applies IFRS 7 before 1 January 2006. The Board noted that such an exemption for first-time adopters exists in IAS 32 and IFRS 4 and that the reasons for providing the exemption apply equally to IFRS 7.

BC68 The Board also considered whether it should provide an exemption from presenting all or some of the comparative information to encourage early adoption of IFRS 7 by entities that already apply IFRSs.

BC69 The Board noted that IFRS 7 contains two types of disclosures: accounting disclosures (in paragraphs 7-30) that are based on requirements previously in IAS 32 and new risk disclosures (in paragraphs 31-42). The Board concluded that existing users of IFRSs already will have complied with the requirements of IAS 32 and will not encounter difficulty in providing comparative information for the accounting disclosures.

BC70 The Board noted that most of the risk disclosures, in particular those about market risk, are based on information collected at the end of the reporting period. The Board concluded that although IFRS 7 was published in August 2005, it will still be possible for entities to collect the information that they require to comply with IFRS 7 for accounting periods beginning in 2005. However, it would not always be possible to collect the information needed to provide comparative information about accounting periods that began in 2004. As a result, the Board decided that entities that apply IFRS 7 for accounting periods beginning in 2005 (ie before 1 January 2006) need not present comparative information about the risk disclosures.

BC71 The Board also noted that comparative disclosures about risk are less relevant because these disclosures are intended to have predictive value. As a result information about risk loses relevance more quickly than other types of disclosure, and any disclosures required by previous GAAP are unlikely to be comparable with those required by IFRS 7. Accordingly, the Board decided that an entity that is not a first-time adopter and applies IFRS 7 for annual periods beginning before 1 January 2006 need not present comparative disclosures about the nature and extent of risks arising from financial instruments. In reaching this conclusion, the Board noted that the advantages of encouraging more entities to apply IFRS 7 early outweighed the disadvantage of the reduced information provided.

BC72 The Board considered and rejected arguments that it should extend the exemption:

(a) from providing comparative information to first-time adopters that applied IFRS 7 before 1 January 2007 (rather than only those that applied IFRS 7 before 1 January 2006). The Board concluded that an entity that intends to adopt IFRSs for the first time on or after 1 January 2006 will have sufficient time to collect information for its accounting period beginning on or after 1 January 2005 and, thus, should not have difficulty in providing the comparative disclosures for accounting periods beginning on or after 1 January 2006.

(b) from providing comparative disclosures about the significance of financial instruments to all entities adopting the IFRS for annual periods beginning before 1 January 2006 (rather than only to first-time adopters). The Board concluded that only first-time adopters warranted special relief so that they would be able to adopt IFRS 7 early without first having to adopt IAS 32 and IAS 30 for only one period. Entities that are not first-time adopters already apply IAS 32 and IAS 30 and have no particular need to adopt IFRS 7 before 1 January 2007.

(c) from providing comparative disclosures about risk to periods beginning before 1 January 2007 (rather than 2006). The Board noted that entities adopting IFRS 7 after 1 January 2006 would have a full calendar year to prepare after the publication of the IFRS.

Summary of main changes from the exposure draft

BC73 The main changes to the proposals in ED 7 are:

(a) ED 7 proposed disclosure of the amount of change in the fair value of a financial liability designated as at fair value through profit or loss that is not attributable to changes in a benchmark interest rate as a proxy for the amount of change in fair value attributable to changes in the instrument's credit risk. The IFRS permits entities to determine the amount of change in fair value attributable to changes in the instrument's credit risk using an alternative method if the entity believes that its alternative method gives more faithful representation. The proxy disclosure has been amended to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. As a result, entities may exclude factors other than a change in a benchmark interest rate when calculating the proxy.

(b) a requirement has been added for disclosures about the difference between the transaction price at initial recognition (used as fair value in accordance with paragraph AG76 of IAS 39) and the results of a valuation technique that will be used for subsequent measurement.

(c) no disclosure is required of the fair value of collateral pledged as security and other credit enhancements as was proposed in ED 7.

(d) the sensitivity analysis requirements have been clarified.

(e) the exemption from presenting comparatives has been widened.

(f) the capital disclosures are a stand-alone amendment to IAS 1, rather than part of the IFRS. No disclosure is required of whether the entity has complied with capital targets set by management and of the consequences of any non-compliance with those targets.

(g) the amendments to IFRS 4 related to IFRS 7 have been modified to reduce systems changes for insurers.

APPENDIX A
Amendments to Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 7. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Basis for Conclusions was issued have been incorporated into the relevant Basis for Conclusions.

HKFRS 7 IG
Revised ~~February 2012~~May 2014

Guidance on Implementing
Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

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

CONTENTS

Guidance on Implementing IFRS 7 *Financial Instruments: Disclosures*

This guidance accompanies, but is not part of, IFRS 7.

Introduction

IG1 This guidance suggests possible ways to apply some of the disclosure requirements in IFRS 7. The guidance does not create additional requirements.

IG2 For convenience, each disclosure requirement in the IFRS is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

IG3-IG4 [Deleted]

Classes of financial instruments and level of disclosure (paragraphs 6 and B1-B3)

IG5 Paragraph B3 states that "an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics." To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.

IG6 Paragraph 17(c) of IAS 1 requires an entity to "provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

Significance of financial instruments for financial position and performance (Paragraphs 7-30, B4 and B5)

Financial liabilities at fair value through profit or loss (paragraphs 10(a)(i) and B4)

IG7 The following example illustrates the calculation that an entity might perform in accordance with paragraph B4 of Appendix B of the IFRS.

IG8 On 1 January 20X1, an entity issues a 10-year bond with a par value of CU150,000[+] and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.

IG9 The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:

(a) LIBOR has decreased to 4.75 per cent.

(b) the fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.[*]

IG10 The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.

IG11 The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

[paragraph B4(a)] First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.	At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent. Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.
[paragraph B4(b)] Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph B4(a).	The contractual cash flows of the instrument at the end of the period are: • interest: CU12,000[(a)] per year for each of years 2-10. • principal: CU150,000 in year 10. The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is 4.75 per cent end of period LIBOR rate, plus the 3 per cent instrument-specific component. This gives a present value of CU152,367.[(b)]
	continued…

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

[*] This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

…continued	
[paragraph B4(c)] The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph B4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed	The market price of the liability at the end of the period is CU153,811.[c] Thus, the entity discloses CU1,444, which is CU153,811-CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.
(a) CU150,000x8% = CU12,000 (b) PV= $[CU12,000x(1-(1+0.0775)^{-9})/0.0775]+CU150,000x(1+0.0775)^{-9}$ (c) market price = $[CU12,000x(1-(1+0.076)^{-9})/0.076]+CU150,000x(1+0.076)^{-9}$	

Defaults and breaches (paragraphs 18 and 19)

IG12 Paragraphs 18 and 19 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with IAS 1.

Total interest expense (paragraph 20(b))*

IG13 Total interest expense disclosed in accordance with paragraph 20(b) is a component of finance costs, which paragraph 82(b) of IAS 1 requires to be presented separately in the statement of comprehensive income. The line item for finance costs may also include amounts associated with non-financial liabilities.

Fair value (paragraphs 27-28)

<u>IG13A-IG13B</u> <u>[Deleted]</u>

~~IG13A IFRS 7 requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorised for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 27B(a). (Disclosure of comparative information is also required, but is not included in the following example.)~~

* In *Improvements to IFRSs* issued in May 2008, the Board amended paragraph IG13 and removed 'total interest income' as a component of finance costs. This amendment removed an inconsistency with paragraph 32 of IAS 1 *Presentation of Financial Statements*, which precludes the offsetting of income and expenses (except when required or permitted by an IFRS).

~~Assets measured at fair value~~		~~Fair value measurement at the end of the reporting period using:~~		
		~~Level 1~~	~~Level 2~~	~~Level 3~~
~~**Description**~~	~~**31 Dec 20X2**~~	~~**CU million**~~	~~**CU million**~~	~~**CU million**~~
~~Financial assets at fair value through profit or loss~~				
~~Trading securities~~	~~100~~	~~40~~	~~55~~	~~5~~
~~Trading derivatives~~	~~39~~	~~17~~	~~20~~	~~2~~
~~Available-for-sale financial assets~~				
~~Equity investments~~	~~75~~	~~30~~	~~40~~	~~5~~
~~**Total**~~	~~214~~	~~87~~	~~115~~	~~12~~

~~(Note: For liabilities, a similar table might be presented.)~~

~~IG13B IFRS 7 requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 27B(c). (Disclosure of comparative information is also required, but is not included in the following example.)~~

~~**Assets measured at fair value based on Level 3**~~				
	~~**Fair value measurement at the end of the reporting period:**~~			
	~~**Financial assets at fair value through profit or loss**~~		~~**Available-for-sale financial assets**~~	~~**Total**~~
	~~Trading securities~~	~~Trading derivatives~~	~~Equity investments~~	
	~~CU million~~	~~CU million~~	~~CU million~~	~~CU million~~
~~Opening balance~~	~~6~~	~~5~~	~~4~~	~~15~~
~~Total gains or losses~~				
~~in profit or loss~~	~~(2)~~	~~(2)~~	~~-~~	~~(4)~~
~~in other comprehensive income~~	~~-~~	~~-~~	~~(1)~~	~~(1)~~
~~Purchases~~	~~1~~	~~2~~	~~2~~	~~5~~
~~Issues~~	~~-~~	~~-~~	~~-~~	~~-~~
~~Settlements~~	~~-~~	~~(1)~~	~~-~~	~~(1)~~
~~Transfers out of Level 3~~	~~-~~	~~(2)~~	~~-~~	~~(2)~~
~~Closing balance~~	~~5~~	~~2~~	~~5~~	~~12~~
~~Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period~~	~~(1)~~	~~(1)~~	~~-~~	~~(2)~~

~~(Note: For liabilities, a similar table might be presented.)~~

~~Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:~~

	~~Trading income~~
~~Total gains or losses included in profit or loss for the period~~	~~(4)~~
~~Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period~~	~~(2)~~

~~(Note: For liabilities, a similar table might be presented.)~~

IG14 The fair value at initial recognition of financial instruments that are not traded in active markets is ~~determined~~ measured in accordance with IFRS 13 *Fair Value Measurement* and paragraph AG76 of IAS 39. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IAS 39 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would ~~consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~AG76A~~ AG76(b) of IAS 39). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

Background

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to ~~establish~~ measure the financial assets' fair value. This valuation technique ~~includes variables~~use inputs other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at 1 January 20X1.

Application of requirements

The entity's 20X2 disclosure would include the following:

Accounting policies

The entity uses the following valuation technique to ~~determine~~ measure the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IFRS 13 and IAS 39, is ~~generally~~ normally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IAS 39, the fair value of an instrument at inception is ~~generally~~ normally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognised in profit or loss are as follows:

	31 Dec X2 CU million	**31 Dec X1 CU million**
Balance at beginning of year	5.3	5.0
New transactions	-	1.0
Amounts recognised in profit or loss during the year	(0.7)	(0.8)
Other increases	-	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	4.5	5.3

Nature and extent of risks arising from financial instruments (paragraphs 31-42 and B6-B28)

Qualitative disclosures (paragraph 33)

IG15 The type of qualitative information an entity might disclose to meet the requirements in paragraph 33 includes, but is not limited to, a narrative description of:

(a) the entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.

(b) the entity's policies and processes for accepting, measuring, monitoring and controlling risk, which might include:

(i) the structure and organisation of the entity's risk management function(s), including a discussion of independence and accountability;

(ii) the scope and nature of the entity's risk reporting or measurement systems;

(iii) the entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and

(iv) the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

(c) the entity's policies and procedures for avoiding excessive concentrations of risk.

IG16 Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.

IG17 In accordance with paragraph 33(c), entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

Quantitative disclosures (paragraphs 34-42 and B7-B28)

IG18 Paragraph 34 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:

(a) industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.

(b) credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.

(c) geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.

(d) a limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realise liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

IG19 In accordance with paragraph B8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.

IG20 When quantitative information at the end of the reporting period is unrepresentative of the entity's exposure to risk during the period, paragraph 35 requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest and average exposures.

Credit risk (paragraphs 36-38, B9 and B10)

IG21 Paragraph 36 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans, and commercial loans each have different economic characteristics.

Collateral and other credit enhancements pledged (paragraph 36(b))

IG22 Paragraph 36(b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:

(a) the policies and processes for valuing and managing collateral and other credit enhancements obtained;

(b) a description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with IAS 32);

(c) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(d) information about risk concentrations within the collateral or other credit enhancements.

Credit quality (paragraph 36(c))

IG23 Paragraph 36(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:

(a) an analysis of credit exposures using an external or internal credit grading system;

(b) the nature of the counterparty;

(c) historical information about counterparty default rates; and

(d) any other information used to assess credit quality.

IG24 When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:

(a) the amounts of credit exposures for each external credit grade;

(b) the rating agencies used;

(c) the amount of an entity's rated and unrated credit exposures; and

(d) the relationship between internal and external ratings.

IG25 When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:

(a) the internal credit ratings process;

(b) the amounts of credit exposures for each internal credit grade; and

(c) the relationship between internal and external ratings.

Financial assets that are either past due or impaired (paragraph 37)

IG26 A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.

IG27 When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.

IG28 Paragraph 37(a) requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(a) not more than three months;

(b) more than three months and not more than six months;

(c) more than six months and not more than one year; and

(d) more than one year.

IG29 Paragraph 37(b) requires an analysis of impaired financial assets by class. This analysis might include:

(a) the carrying amount, before deducting any impairment loss;

(b) the amount of any related impairment loss; and

(c) the nature and fair value of collateral available and other credit enhancements obtained.

IG30-IG31 [Deleted]

Market risk (paragraphs 40-42 and B17-B28)

IG32 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (ie the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (eg a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:

(a) the yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.

(b) foreign exchange rates.

(c) prices of equity instruments.

(d) market prices of commodities.

IG33 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:

(a) prevailing market interest rates, for interest-sensitive financial instruments such as a variable-rate loan; or

(b) currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

IG34 For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:

(a) interest income and expense;

(b) other line items of profit or loss (such as trading gains and losses); and

(c) when applicable, equity.

An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.

IG35 Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.

IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

> **Interest rate risk**
>
> At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been CU1.7 million (20X1–CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other comprehensive income would have been CU2.8 million (20X1–CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been CU1.5 million (20X1–CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, and other comprehensive income would have been CU3.0 million (20X1–CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).[a]
>
> **Foreign currency exchange rate risk**
>
> At 31 December 20X2, if the CU had weakened 10 per cent against the US dollar with all other variables held constant, post-tax profit for the year would have been CU2.8 million (20X1–CU6.4 million) lower, and other comprehensive income would have been CU1.2 million (20X1–CU1.1 million) higher. Conversely, if the CU had strengthened 10 per cent against the US dollar with all other variables held constant, post-tax profit would have been CU2.8 million (20X1–CU6.4 million) higher, and other comprehensive income would have been CU1.2 million (20X1–CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in profit in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Equity is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.
>
> (a) Paragraph 39(a) requires disclosure of a maturity analysis of liabilities.

Other market risk disclosures (paragraph 42)

IG37 Paragraph 42 requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

(a) a financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis, eg options that remain out of (or in) the money for the chosen change in the risk variable;

(b) financial assets are illiquid, eg when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty; or

(c) an entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38 In the situation in paragraph IG37(a), additional disclosure might include:

(a) the terms and conditions of the financial instrument (eg the options);

(b) the effect on profit or loss if the term or condition were met (ie if the options were exercised); and

(c) a description of how the risk is hedged.

For example, an entity may acquire a zero-cost interest rate collar that includes an out-of-the-money leveraged written option (eg the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39 In the situation described in paragraph IG37(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40 In the situation described in paragraph IG37(c), additional disclosure might include:

(a) the nature of the security (eg entity name);

(b) the extent of holding (eg 15 per cent of the issued shares);

(c) the effect on profit or loss; and

(d) how the entity hedges the risk.

Derecognition (paragraphs 42D and 42E)

IG40A The following examples illustrate some possible ways to meet the quantitative disclosure requirements in paragraphs 42D and 42E.

IG40B The following examples illustrate how an entity that has adopted IFRS 9 *Financial Instruments* might meet the quantitative disclosure requirements in paragraphs 42D and 42E.

Transferred financial assets that are not derecognised in their entirety

Illustrating the application of paragraph 42D(d) and (e)

	Financial assets at fair value through profit or loss		**Financial assets at amortised cost**		**Financial assets at fair value through other comprehensive income**
	CU million		CU million		CU million
	Trading assets	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised in their entirety

Illustrating the application of paragraph 42E(a)–(d)

	Cash outflows to repurchase transferred (derecognised) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
Type of continuing involvement		**Financial assets at fair value through profit or loss**	**Financial assets at fair value through other compre-hensive income**	**Financial liabilities at fair value through profit or loss**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)			(X)	X	(X)	X
Total		X		(X)	X	(X)	X

Illustrating the application of paragraph 42E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

IG40C The following examples illustrate how an entity that has not adopted IFRS 9 might meet the quantitative disclosure requirements in paragraphs 42D and 42E.

Transferred financial assets that are not derecognised in their entirety

Illustrating the application of paragraph 42D(d) and (e)

	Financial assets at fair value through profit or loss		**Loans and receivables**		**Available-for-sale financial assets**
	CU million		CU million		CU million
	Trading securities	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised in their entirety

Illustrating the application of paragraph 42E(a)–(d)

	Cash outflows to repurchase transferred (derecognised) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
Type of continuing involvement		**Held for trading**	**Available-for-sale financial assets**	**Financial liabilities at fair value through profit or loss**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)		X	(X)	X	(X)	X
Total		X	X	(X)	X	(X)	X

Illustrating the application of paragraph 42E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

Disclosures (paragraphs 13A–13F and B40–B53)

IG40D The following examples illustrate ways in which an entity might provide the quantitative disclosures required by paragraph 13C. However, these illustrations do not address all possible ways of applying the disclosure requirements as set out in paragraphs 13B–13E.

Background

An entity has entered into transactions subject to an enforceable master netting arrangement or similar agreement with the following counterparties. The entity has the following recognised financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 13A.

Counterparty A:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty A that meet the offsetting criteria in paragraph 42 of IAS 32. Consequently, the gross derivative liability is set off against the gross derivative asset, resulting in the presentation of a net derivative asset of CU20 million in the entity's statement of financial position. Cash collateral has also been received from Counterparty A for a portion of the net derivative asset (CU10 million). The cash collateral of CU10 million does not meet the offsetting criteria in paragraph 42 of IAS 32, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty B:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty B that do not meet the offsetting criteria in paragraph 42 of IAS 32, but which the entity has the right to set off in the case of default and insolvency or bankruptcy. Consequently, the gross amount of the derivative asset (CU100 million) and the gross amount of the derivative liability (CU80 million) are presented separately in the entity's statement of financial position. Cash collateral has also been received from Counterparty B for the net amount of the derivative asset and derivative liability (CU20 million). The cash collateral of CU20 million does not meet the offsetting criteria in paragraph 42 of IAS 32, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

continued...

...continued

Counterparty C:

The entity has entered into a sale and repurchase agreement with Counterparty C that is accounted for as a collateralised borrowing. The carrying amount of the financial assets (bonds) used as collateral and posted by the entity for the transaction is CU79 million and their fair value is CU85 million. The carrying amount of the collateralised borrowing (repo payable) is CU80 million.

The entity has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as a collateralised lending. The fair value of the financial assets (bonds) received as collateral (and not recognised in the entity's statement of financial position) is CU105 million. The carrying amount of the collateralised lending (reverse repo receivable) is CU90 million.

The transactions are subject to a global master repurchase agreement with a right of set-off only in default and insolvency or bankruptcy and therefore do not meet the offsetting criteria in paragraph 42 of IAS 32. Consequently, the related repo payable and repo receivable are presented separately in the entity's statement of financial position.

Illustrating the application of paragraph 13C(a)–(e) by type of financial instrument

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	**(a)**	**(b)**	**(c)=(a)-(b)**	**(d)**		**(e)=(c)-(d)**
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial liabilities set off in the statement of financial position**	**Net amounts of financial assets presented in the statement of financial position**	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral received**	**Net amount**
Description						
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	-	90	(90)	-	-
Other financial instruments	-	-	-	-	-	-
Total	290	(80)	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial assets set off in the statement of financial position**	**Net amounts of financial liabilities presented in the statement of financial position**	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral pledged**	**Net amount**
Description						
Derivatives	160	(80)	80	(80)	-	-
Repurchase, securities lending and similar agreements	80	-	80	(80)	-	-
Other financial instruments	-	-	-	-	-	-
Total	240	(80)	160	(160)	-	-

Illustrating the application of paragraph 13C(a)–(c) by type of financial instrument and paragraph 13C(c)–(e) by counterparty

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial liabilities set off in the statement of financial position**	**Net amounts of financial assets presented in the statement of financial position**
Description			
Derivatives	200	(80)	120
Reverse repurchase, securities borrowing and similar agreements	90	-	90
Other financial instruments	-	-	-
Total	290	(80)	210

Net financial assets subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at 31 December 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial assets presented in the statement of financial position	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral received**	**Net amount**
Counterparty A	20	-	(10)	10
Counterparty B	100	(80)	(20)	-
Counterparty C	90	(90)	-	-
Other	-	-	-	-
Total	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)
	Gross amounts of recognised financial liabilities	**Gross amounts of recognised financial assets set off in the statement of financial position**	**Net amounts of financial liabilities presented in the statement of financial position**
Description			
Derivatives	160	(80)	80
Repurchase, securities lending and similar agreements	80	-	80
Other financial instruments	-	-	-
Total	240	(80)	160

Net financial liabilities subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at 31 December 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial liabilities presented in the statement of financial position	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral pledged**	**Net amount**
Counterparty A	-	-	-	-
Counterparty B	80	(80)	-	-
Counterparty C	80	(80)	-	-
Other	-	-	-	-
Total	160	(160)	-	-

Transition (paragraph 44)

IG41 The following table summarises the effect of the exemption from presenting comparative accounting and risk disclosures for accounting periods beginning before 1 January 2006, before 1 January 2007, and on or after 1 January 2007. In this table:

(a) a **first-time adopter** is an entity preparing its first IFRS financial statements (see IFRS 1 *First-time Adoption of International Financial Reporting Standards*).

(b) an **existing IFRS user** is an entity preparing its second or subsequent IFRS financial statements.

	Accounting disclosures (paragraphs 7-30)	**Risk disclosures (paragraphs 31-42)**
Accounting periods beginning before 1 January 2006		
First-time adopter not applying IFRS 7 early	*Applies IAS 32 but exempt from providing IAS 32 comparative information*	*Applies IAS 32 but exempt from providing IAS 32 comparative information*
First-time adopter applying IFRS 7 early	**Exempt from presenting IFRS 7 comparative information**	**Exempt from presenting IFRS 7 comparative information**
Existing IFRS user not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
Existing IFRS user applying IFRS 7 early	Provides full IFRS 7 comparative information	**Exempt from presenting IFRS 7 comparative information**[(a)]
		continued …

Accounting periods beginning on or after 1 January 2006 and before 1 January 2007		
First-time adopter not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
First-time adopter applying IFRS 7 early	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Existing IFRS user not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
Existing IFRS user applying IFRS 7 early	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Accounting periods beginning on or after 1 January 2007 (mandatory application of IFRS 7)		
First-time adopter	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Existing IFRS user	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
(a) See paragraph 44 of IFRS 7		

APPENDIX A
Amendments to guidance on other IFRSs

This appendix contains amendments to guidance on IFRSs other than IFRS 4 that are necessary in order to ensure consistency with IFRS 7. Amendments to the Guidance on Implementing IFRS 4 will be published at a later date. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Implementation Guidance was issued have been incorporated into the relevant Implementation Guidance.

HK(IFRIC)-Int 14
Revised ~~April 2012~~May 2014

Effective for annual periods
beginning on or after 1 January 2008

HK (IFRIC) Interpretation 14

HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

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

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from paragraph

HONG KONG (IFRIC) INTERPRETATION 14
HKAS 19—THE LIMIT ON A DEFINED BENEFIT ASSET, MINIMUM FUNDING REQUIREMENTS AND THEIR INTERACTION

Hong Kong (IFRIC) Interpretation 14 *HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (HK(IFRIC)-Int 14) is set out in paragraphs 1–29. HK(IFRIC)-Int 14 is accompanied by illustrative examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 14
HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

References

- HKAS 1 *Presentation of Financial Statements*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 19 *Employee Benefits* (as amended in 2011)
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Background

1 Paragraph ~~58~~64 of HKAS 19 limits the measurement of a net defined benefit asset to the lower of the surplus in the defined benefit plan and the the asset ceiling. Paragraph 8 of HKAS 19 defines the asset ceiling as "the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan"~~ plus unrecognised gains and losses~~. Questions have arisen about when refunds or reductions in future contributions should be regarded as available, particularly when a minimum funding requirement exists.

2 Minimum funding requirements exist in many countries to improve the security of the post-employment benefit promise made to members of an employee benefit plan. Such requirements normally stipulate a minimum amount or level of contributions that must be made to a plan over a given period. Therefore, a minimum funding requirement may limit the ability of the entity to reduce future contributions.

3 Further, the limit on the measurement of a defined benefit asset may cause a minimum funding requirement to be onerous. Normally, a requirement to make contributions to a plan would not affect the measurement of the defined benefit asset or liability. This is because the contributions, once paid, will become plan assets and so the additional net liability is nil. However, a minimum funding requirement may give rise to a liability if the required contributions will not be available to the entity once they have been paid.

3A In December 2009 the Hong Kong Institute of Certified Public Accountants amended HK(IFRIC)-Int 14 to remove an unintended consequence arising from the treatment of prepayments of future contributions in some circumstances when there is a minimum funding requirement.

Scope

4 This Interpretation applies to all post-employment defined benefits and other long-term employee defined benefits.

5 For the purpose of this Interpretation, minimum funding requirements are any requirements to fund a post-employment or other long-term defined benefit plan.

Issues

6 The issues addressed in this Interpretation are:

(a) when refunds or reductions in future contributions should be regarded as available in accordance with the definition of the asset ceiling in paragraph 8 ~~paragraph 58~~ of HKAS 19.

(b) how a minimum funding requirement might affect the availability of reductions in future contributions.

(c) when a minimum funding requirement might give rise to a liability.

Conclusions

Availability of a refund or reduction in future contributions

7 An entity shall determine the availability of a refund or a reduction in future contributions in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan.

8 An economic benefit, in the form of a refund or a reduction in future contributions, is available if the entity can realise it at some point during the life of the plan or when the plan liabilities are settled. In particular, such an economic benefit may be available even if it is not realisable immediately at the end of the reporting period.

9 The economic benefit available does not depend on how the entity intends to use the surplus. An entity shall determine the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both. An entity shall not recognise economic benefits from a combination of refunds and reductions in future contributions based on assumptions that are mutually exclusive.

10 In accordance with HKAS 1, the entity shall disclose information about the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amount of the net asset or liability recognised in the statement of financial position. This might include disclosure of any restrictions on the current realisability of the surplus or disclosure of the basis used to determine the amount of the economic benefit available.

The economic benefit available as a refund

The right to a refund

11 A refund is available to an entity only if the entity has an unconditional right to a refund:

(a) during the life of the plan, without assuming that the plan liabilities must be settled in order to obtain the refund (eg in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); or

(b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or

(c) assuming the full settlement of the plan liabilities in a single event (ie as a plan wind-up).

An unconditional right to a refund can exist whatever the funding level of a plan at the end of the reporting period.

12 If the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset.

Measurement of the economic benefit

13 An entity shall measure the economic benefit available as a refund as the amount of the surplus at the end of the reporting period (being the fair value of the plan assets less the present value of the defined benefit obligation) that the entity has a right to receive as a refund, less any associated costs. For instance, if a refund would be subject to a tax other than income tax, an entity shall measure the amount of the refund net of the tax.

14 In measuring the amount of a refund available when the plan is wound up (paragraph 11(c)), an entity shall include the costs to the plan of settling the plan liabilities and making the refund. For example, an entity shall deduct professional fees if these are paid by the plan rather than the entity, and the costs of any insurance premiums that may be required to secure the liability on wind-up.

15 If the amount of a refund is determined as the full amount or a proportion of the surplus, rather than a fixed amount, an entity shall make no adjustment for the time value of money, even if the refund is realisable only at a future date.

The economic benefit available as a contribution reduction

16 If there is no minimum funding requirement for contributions relating to future service, the economic benefit available as a reduction in future contributions is the future service cost to the entity for each period over the shorter of the expected life of the plan and the expected life of the entity. The future service cost to the entity excludes amounts that will be borne by employees.

17 An entity shall determine the future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by HKAS 19. Therefore, an entity shall assume no change to the benefits to be provided by a plan in the future until the plan is amended and shall assume a stable workforce in the future unless the entity ~~is demonstrably committed at the end of the reporting period to~~ makes a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforce shall include the reduction.

The effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions

18 An entity shall analyse any minimum funding requirement at a given date into contributions that are required to cover (a) any existing shortfall for past service on the minimum funding basis and (b) future service.

19 Contributions to cover any existing shortfall on the minimum funding basis in respect of services already received do not affect future contributions for future service. They may give rise to a liability in accordance with paragraphs 23–26.

20 If there is a minimum funding requirement for contributions relating to future service, the economic benefit available as a reduction in future contributions is the sum of:

(a) any amount that reduces future minimum funding requirement contributions for future service because the entity made a prepayment (ie paid the amount before being required to do so); and

(b) the estimated future service cost in each period in accordance with paragraphs 16 and 17, less the estimated minimum funding requirement contributions that would be required for future service in those periods if there were no prepayment as described in (a).

21 An entity shall estimate the future minimum funding requirement contributions for future service taking into account the effect of any existing surplus determined using the minimum funding basis but excluding the prepayment described in paragraph 20(a). An entity shall use assumptions consistent with the minimum funding basis and, for any factors not specified by that basis, assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by HKAS 19. The estimate shall include any changes expected as a result of the entity paying the minimum contributions when they are due. However, the estimate shall not include the effect of expected changes in the terms and conditions of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period.

22 When an entity determines the amount described in paragraph 20(b), if the future minimum funding requirement contributions for future service exceed the future HKAS 19 service cost in any given period, that excess reduces the amount of the economic benefit available as a reduction in future contributions. However, the amount described in paragraph 20(b) can never be less than zero.

When a minimum funding requirement may give rise to a liability

23 If an entity has an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan.

24 To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability when the obligation arises. The liability shall reduce the net defined benefit asset or increase the net defined benefit liability so that no gain or loss is expected to result from applying paragraph ~~58~~64 of HKAS 19 when the contributions are paid.

25 [Deleted]~~An entity shall apply paragraph 58A of HKAS 19 before determining the liability in accordance with paragraph 24.~~

26 [Deleted]~~The liability in respect of the minimum funding requirement and any subsequent remeasurement of that liability shall be recognised immediately in accordance with the entity's adopted policy for recognising the effect of the limit in paragraph 58 in HKAS 19 on the measurement of the defined benefit asset. In particular:~~

~~(a) an entity that recognises the effect of the limit in paragraph 58 in profit or loss, in accordance with paragraph 61(g) of HKAS 19, shall recognise the adjustment immediately in profit or loss.~~

~~(b) an entity that recognises the effect of the limit in paragraph 58 in other comprehensive income, in accordance with paragraph 93C of HKAS 19, shall recognise the adjustment immediately in other comprehensive income.~~

Effective date

27 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008. Earlier application is permitted.

27A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 26. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

27B *Prepayments of a Minimum Funding Requirement* added paragraph 3A and amended paragraphs 16–18 and 20–22. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

27C HKAS 19 (as amended in 2011) amended paragraphs 1, 6, 17 and 24 and deleted paragraphs 25 and 26. An entity shall apply those amendments when it applies HKAS 19 (as amended in 2011).

Transition

28 An entity shall apply this Interpretation from the beginning of the first period presented in the first financial statements to which the Interpretation applies. An entity shall recognise any initial adjustment arising from the application of this Interpretation in retained earnings at the beginning of that period.

29 An entity shall apply the amendments in paragraphs 3A, 16–18 and 20–22 from the beginning of the earliest comparative period presented in the first financial statements in which the entity applies this Interpretation. If the entity had previously applied this Interpretation before it applies the amendments, it shall recognise the adjustment resulting from the application of the amendments in retained earnings at the beginning of the earliest comparative period presented.

Illustrative examples

These examples accompany, but are not part of, IFRIC 14.

Example 1—Effect of the minimum funding requirement when there is an IAS 19 surplus and the minimum funding contributions payable are fully refundable to the entity

IE1 An entity has a funding level on the minimum funding requirement basis (which is measured on a different basis from that required under IAS 19) of 82 per cent in Plan A. Under the minimum funding requirements, the entity is required to increase the funding level to 95 per cent immediately. As a result, the entity has a statutory obligation at the end of the reporting period to contribute 200 to Plan A immediately. The plan rules permit a full refund of any surplus to the entity at the end of the life of the plan. The year-end valuations for Plan A are set out below.

~~Market value~~Fair value of assets	1,200
Present value of defined benefit obligation under IAS 19	(1,100)
Surplus	100
~~Defined benefit asset (before consideration of the minimum funding requirement)[(a)]~~	~~100~~

~~(a) For simplicity, it is assumed that there are no unrecognised amounts.~~

Application of requirements

IE2 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the contributions payable are not fully available. Payment of the contributions of 200 will increase the IAS 19 surplus from 100 to 300. Under the rules of the plan this amount will be fully refundable to the entity with no associated costs. Therefore, no liability is recognised for the obligation to pay the contributions and the net defined benefit asset is 100.

Example 2—Effect of a minimum funding requirement when there is an IAS 19 deficit and the minimum funding contributions payable would not be fully available

IE3 An entity has a funding level on the minimum funding requirement basis (which is measured on a different basis from that required under IAS 19) of 77 per cent in Plan B. Under the minimum funding requirements, the entity is required to increase the funding level to 100 per cent immediately. As a result, the entity has a statutory obligation at the end of the reporting period to pay additional contributions of 300 to Plan B. The plan rules permit a maximum refund of 60 per cent of the IAS 19 surplus to the entity and the entity is not permitted to reduce its contributions below a specified level which happens to equal the IAS 19 service cost. The year-end valuations for Plan B are set out below.

~~Market value~~Fair value of assets	1,000
Present value of defined benefit obligation under IAS 19	(1,100)
Deficit	(100)
~~Defined benefit (liability) (before consideration of the minimum funding requirement)[(a)]~~	~~(100)~~

~~(a) For simplicity, it is assumed that there are no unrecognised amounts~~

Application of requirements

IE4 The payment of 300 would change the IAS 19 deficit of 100 to a surplus of 200. Of this 200, 60 per cent (120) is refundable.

IE5 Therefore, of the contributions of 300, 100 eliminates the IAS 19 deficit and 120 (60 per cent of 200) is available as an economic benefit. The remaining 80 (40 per cent of 200) of the contributions paid is not available to the entity.

IE6 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the additional contributions payable are not available to it.

IE7 Therefore, the net defined benefit liability is 180, comprising the deficit of 100 plus the additional liability of 80 resulting from the requirements in paragraph 24 of IFRIC 14 ~~the entity increases the defined benefit liability by 80. As required by paragraph 26 of IFRIC 14, 80 is recognised immediately in accordance with the entity's adopted policy for recognising the effect of the limit in paragraph 58 and the entity recognises a net liability of 180 in the statement of financial position~~. No other liability is recognised in respect of the statutory obligation to pay contributions of 300.

Summary

~~Market value~~Fair value of assets	1,000
Present value of defined benefit obligation under IAS 19	(1,100)
Deficit	(100)
~~Defined benefit liability (before consideration of the minimum funding requirement)[(a)]~~	~~(100)~~
Effect of the asset ceiling~~Adjustment in respect of minimum funding requirement~~	(80)
Net defined benefit liability~~Net liability recognised in the statement of financial position~~	(180)

~~(a) For simplicity, it is assumed that there are no unrecognised amounts.~~

IE8 When the contributions of 300 are paid, the net defined benefit asset ~~recognised in the statement of financial position~~ will be 120.

Example 3—Effect of a minimum funding requirement when the contributions payable would not be fully available and the effect on the economic benefit available as a future contribution reduction

IE9 An entity has a funding level on the minimum funding basis (which it measures on a different basis from that required by IAS 19) of 95 per cent in Plan C. The minimum funding requirements require the entity to pay contributions to increase the funding level to 100 per cent over the next three years. The contributions are required to make good the deficit on the minimum funding basis (shortfall) and to cover future service.

IE10 Plan C also has an IAS 19 surplus at the end of the reporting period of 50, which cannot be refunded to the entity under any circumstances. ~~There are no unrecognised amounts.~~

IE11 The nominal amounts of contributions required to satisfy the minimum funding requirements in respect of the shortfall and the future service for the next three years are set out below.

Year	Total contributions for minimum funding requirement	Contributions required to make good the shortfall	Contributions required to cover future service
1	135	120	15
2	125	112	13
3	115	104	11

Application of requirements

IE12 The entity's present obligation in respect of services already received includes the contributions required to make good the shortfall but does not include the contributions required to cover future service.

IE13 The present value of the entity's obligation, assuming a discount rate of 6 per cent per year, is approximately 300, calculated as follows:

$[120/(1.06) + 112 /(1.06)^2 + 104/(1.06)^3]$.

IE14 When these contributions are paid into the plan, ~~the present value of~~ the IAS 19 surplus (ie the fair value of assets less the present value of the defined benefit obligation) would, other things being equal, increase from 50 to 350 (300 + 50).

IE15 However, the surplus is not refundable although an asset may be available as a future contribution reduction.

IE16 In accordance with paragraph 20 of IFRIC 14, the economic benefit available as a reduction in future contributions is the sum of:

(a) any amount that reduces future minimum funding requirement contributions for future service because the entity made a prepayment (ie paid the amount before being required to do so); and

(b) the estimated future service cost in each period in accordance with paragraphs 16 and 17, less the estimated minimum funding requirement contributions that would be required for future service in those periods if there were no prepayment as described in (a).

IE17 In this example there is no prepayment as described in paragraph 20(a). The amounts available as a reduction in future contributions when applying paragraph 20(b) are set out below.

Year	IAS 19 service cost	Minimum contributions required to cover future service	Amount available as contribution reduction
1	13	15	(2)
2	13	13	0
3	13	11	2
4+	13	9	4

IE18 Assuming a discount rate of 6 per cent, the present value of the economic benefit available as a future contribution reduction is therefore equal to:

$(2)/(1.06) + 0/(1.06)^2 + 2/(1.06)^3 + 4/(1.06)^4 \ldots. = 56.$

Thus in accordance with paragraph 58(b) of IAS 19, the present value of the economic benefit available from future contribution reductions is limited to 56.

IE19 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the additional contributions payable will not be fully available. Therefore, the ~~entity reduces the defined benefit asset by~~effect of the asset ceiling is 294 (50 + 300 - 56).

IE20 ~~As required by paragraph 26 of IFRIC 14, the 294 is recognised immediately in accordance with the entity's adopted policy for recognising the effect of the limit in paragraph 58 and t~~The entity recognises a net defined benefit liability of 244 in the statement of financial position. No other liability is recognised in respect of the obligation to make contributions to fund the minimum funding shortfall.

Summary

Surplus	50
Net ~~D~~defined benefit asset (before consideration of the minimum funding requirement)	50
~~Adjustment in respect of minimum funding requirement~~Effect of the asset ceiling	(294)
Net defined benefit liability ~~recognised in the statement of financial position[(a)]~~	(244)

~~(a) For simplicity, it is assumed that there are no unrecognised amounts.~~

IE21 When the contributions of 300 are paid into the plan, the net asset recognised in the statement of financial position will become 56 (300 - 244).

Example 4—Effect of a prepayment when a minimum funding requirement exceeds the expected future service charge

IE22 An entity is required to fund Plan D so that no deficit arises on the minimum funding basis. The entity is required to pay minimum funding requirement contributions to cover the service cost in each period determined on the minimum funding basis.

IE23 Plan D has an IAS 19 surplus of 35 at the beginning of 20X1. ~~There are no cumulative unrecognised net actuarial losses and past service costs.~~ This example assumes that the discount rate and expected return on assets are 0 per cent, and that the plan cannot refund the surplus to the entity under any circumstances but can use the surplus for reductions of future contributions.

IE24 The minimum contributions required to cover future service are 15 for each of the next five years. The expected IAS 19 service cost is 10 in each year.

IE25 The entity makes a prepayment of 30 at the beginning of 20X1 in respect of years 20X1 and 20X2, increasing its surplus at the beginning of 20X1 to 65. That prepayment reduces the future contributions it expects to make in the following two years, as follows:

Year	IAS 19 service cost	Minimum funding requirement contribution before prepayment	Minimum funding requirement contribution after prepayment
20X1	10	15	0
20X2	10	15	0
20X3	10	15	15
20X4	10	15	15
20X5	10	15	15
Total	50	75	45

Application of requirements

IE26 In accordance with paragraphs 20 and 22 of IFRIC 14, at the beginning of 20X1, the economic benefit available as a reduction in future contributions is the sum of:

(a) 30, being the prepayment of the minimum funding requirement contributions; and

(b) nil. The estimated minimum funding requirement contributions required for future service would be 75 if there was no prepayment. Those contributions exceed the estimated future service cost (50); therefore the entity cannot use any part of the surplus of 35 noted in paragraph IE23 (see paragraph 22).

IE27 Assuming a discount rate of 0 per cent, the present value of the economic benefit available as a reduction in future contributions is equal to 30. Thus in accordance with paragraph ~~58~~64 of IAS 19 the entity recognises ~~an~~net defined benefit asset of 30 (because this is lower than the IAS 19 surplus of 65).

Basis for Conclusions on IFRIC Interpretation 14 *IAS 19 – The Limited on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

This Basis for Conclusions accompanies, but is not part of, IFRIC 14.

HK(IFRIC)-Int 14 is based on IFRIC Interpretation 14 *HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. In approving HK(IFRIC)-Int 14, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 14. Accordingly, there are no significant differences between HK(IFRIC)-Int 14 and IFRIC Interpretation 14. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 14 referred to below generally correspond with those in HK(IFRIC)-Int 14.

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC noted that practice varies significantly with regard to the treatment of the effect of a minimum funding requirement on the limit placed by paragraph ~~58~~64 of IAS 19 *Employee Benefits* on the amount of a defined benefit asset. The IFRIC therefore decided to include this issue on its agenda. In considering the issue, the IFRIC also became aware of the need for general guidance on determining the limit on the measurement of the defined benefit asset, and for guidance on when that limit makes a minimum funding requirement onerous.

BC3 The IFRIC published D19 *IAS 19—The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements* in August 2006. In response, the IFRIC received 48 comment letters.

BC3A In November 2009 the International Accounting Standards Board amended IFRIC 14 to remove an unintended consequence arising from the treatment of prepayments in some circumstances when there is a minimum funding requirement (see paragraphs BC30A–BC30D).

Definition of a minimum funding requirement

BC4 D19 referred to statutory or contractual minimum funding requirements. Respondents to D19 asked for further guidance on what constituted a minimum funding requirement. The IFRIC decided to clarify that for the purpose of the Interpretation a minimum funding requirement is any requirement for the entity to make contributions to *fund* a post-employment or other long-term defined benefit plan.

Interaction between IAS 19 and minimum funding requirements

BC5 Funding requirements would not normally affect the accounting for a plan under IAS 19. However, paragraph ~~58~~64 of IAS 19 limits the amount of the net defined benefit asset to the available economic benefit~~ plus unrecognised amounts~~. The interaction of a minimum funding requirement and this limit has two possible effects:

(a) the minimum funding requirement may restrict the economic benefits available as a reduction in future contributions, and

(b) the limit may make the minimum funding requirement onerous because contributions payable under the requirement in respect of services already received may not be available once they have been paid, either as a refund or as a reduction in future contributions.

BC6 These effects raised general questions about the availability of economic benefits in the form of a refund or a reduction in future contributions.

Availability of the economic benefit

BC7 One view of "available" would limit the economic benefit to the amount that is realisable immediately at the end of the reporting period.

BC8 The IFRIC disagreed with this view. The *Framework** defines an asset as a resource "from which future economic benefits are expected to flow to the entity." Therefore, it is not necessary for the economic benefit to be realisable immediately. Indeed, a reduction in future contributions cannot be realisable immediately.

BC9 The IFRIC concluded that a refund or reduction in future contributions is available if it could be realisable at some point during the life of the plan or when the plan liability is settled. Respondents to D19 were largely supportive of this conclusion.

BC10 In the responses to D19, some argued that an entity may expect to use the surplus to give improved benefits. Others noted that future actuarial losses might reduce or eliminate the surplus. In either case there would be no refund or reduction in future contributions. The IFRIC noted that the existence of an asset at the end of the reporting period depends on whether the entity has the right to obtain a refund or reduction in future contributions. The existence of the asset at that date is not affected by possible future changes to the amount of the surplus. If future events occur that change the amount of the surplus, their effects are recognised when they occur. Accordingly, if the entity decides to improve benefits, or future losses in the plan reduce the surplus, the consequences are recognised when the decision is made or the losses occur. The IFRIC noted that such events of future periods do not affect the existence or measurement of the asset at the end of the reporting period.

The asset available as a refund of a surplus

BC11 The IFRIC noted that a refund of a surplus could potentially be obtained in three ways:

(a) during the life of the plan, without assuming that the plan liabilities have to be settled in order to get the refund (eg in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); or

(b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or

(c) assuming the full settlement of the plan liabilities in a single event (ie as a plan wind-up).

BC12 The IFRIC concluded that all three ways should be considered in determining whether an economic benefit was available to the entity. Some respondents to D19 raised the question of when an entity controls an asset that arises from the availability of a refund, in particular if a refund would be available only if a third party (for example the plan trustees) gave its approval. The IFRIC concluded that an entity controlled the asset only if the entity has an unconditional right to the refund. If that right depends on actions by a third party, the entity does not have an unconditional right.

BC13 If the plan liability is settled by an immediate wind-up, the costs associated with the wind-up may be significant. One reason for this may be that the cost of annuities available on the market is expected to be significantly higher than that implied by the IAS 19 basis. Other costs include the legal and other professional fees expected to be incurred during the winding-up process. Accordingly, a plan with an apparent surplus may not be able to recover any of that surplus on wind-up.

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

BC14 The IFRIC noted that the available surplus should be measured at the amount that the entity could receive from the plan. The IFRIC decided that in determining the amount of the refund available on wind-up of the plan, the amount of the costs associated with the settlement and refund should be deducted if paid by the plan.

BC15 The IFRIC noted that the costs of settling the plan liability would be dependent on the facts and circumstances of the plan and it decided not to issue any specific guidance in this respect.

BC16 The IFRIC also noted that the present value of the defined benefit obligation and the fair value of assets are both measured on a present value basis[†] and therefore take into account the timing of the future cash flows. The IFRIC concluded that no further adjustment for the time value of money needs to be made when measuring the amount of a refund determined as the full amount or a proportion of the surplus that is realisable at a future date.

The asset available in the form of a future contribution reduction

BC17 The IFRIC decided that the amount of the contribution reduction available to the entity should be measured with reference to the amount that the entity would have been required to pay had there been no surplus. The IFRIC concluded that is represented by the cost to the entity of accruing benefits in the plan, in other words by the future IAS 19 service cost. Respondents to D19 broadly supported this conclusion.

BC18 When the issue of the availability of reductions in future contributions was first raised with the IFRIC, some expressed the view that an entity should recognise an asset only to the extent that there was a formal agreement between the trustees and the entity specifying contributions payable lower than the IAS 19 service cost. The IFRIC disagreed, concluding instead that an entity is entitled to assume that, in general, it will not be required to make contributions to a plan in order to maintain a surplus and hence that it will be able to reduce contributions if the plan has a surplus. (The effects of a minimum funding requirement on this assumption are discussed below.)

BC19 The IFRIC considered the assumptions that underlie the calculation of the future service cost. In respect of the discount rate, IAS 19 requires the measurement of the present value of the future contribution reduction to be based on the same discount rate as that used to determine the present value of the defined benefit obligation.

BC20 The IFRIC considered whether the term over which the contribution reduction should be calculated should be restricted to the expected future working lifetime of the active membership. The IFRIC disagreed with that view. The IFRIC noted that the entity could derive economic benefit from a reduction in contributions beyond that period. The IFRIC also noted that increasing the term of the calculation has a decreasing effect on the incremental changes to the asset because the reductions in contributions are discounted to a present value. Thus, for plans with a large surplus and no possibility of receiving a refund, the available asset will be limited even if the term of the calculation extends beyond the expected future working lifetime of the active membership to the expected life of the plan. This is consistent with paragraph BC77 of the Basis for Conclusions on IAS 19[*], which states that "the limit [on the measurement of the defined benefit asset] is likely to come into play *only* where … the plan is very mature and has a very large surplus that is more than large enough to eliminate *all* future contributions and cannot be returned to the entity" (emphasis added). If the contribution reduction were determined by considering only the term of the expected future working lifetime of the active membership, the limit on the measurement of the defined benefit asset would come into play much more frequently.

[†] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 does not specify a particular valuation technique for measuring the fair value of plan assets.

[*] As a result of the amendments to IAS 19 in June 2011, paragraph BC 77 has deleted.

BC21 Most respondents to D19 were supportive of this view. However, some argued that the term should be the shorter of the expected life of the plan and the expected life of the entity. The IFRIC agreed that the entity could not derive economic benefits from a reduction in contributions beyond its own expected life and has amended the Interpretation accordingly.

BC22 Next, the IFRIC considered what assumptions should be made about a future workforce. D19 proposed that the assumptions for the demographic profile of the future workforce should be consistent with the assumptions underlying the calculation of the present value of the defined benefit obligation at the end of the reporting period. Some respondents noted that the calculation of service costs for future periods requires assumptions that are not required for the calculation of the defined benefit obligation. In particular, the assumptions underlying the present value of the defined benefit obligation calculation do not include an explicit assumption for new entrants.

BC23 The IFRIC agreed that this is the case. The IFRIC noted that assumptions are needed in respect of the size of the future workforce and future benefits provided by the plan. The IFRIC decided that the future service cost should be based on the situation that exists at the end of the reporting period determined in accordance with IAS 19. Therefore, increases in the size of the workforce or the benefits provided by the plan should not be anticipated. Decreases in the size of the workforce or the benefits should be included in the assumptions for the future service cost at the same time as they are treated as curtailments in accordance with IAS 19.

The effect of a minimum funding requirement on the economic benefit available as a refund

BC24 The IFRIC considered whether a minimum funding requirement to make contributions to a plan in force at the end of the reporting period would restrict the extent to which a refund of surplus is available. The IFRIC noted that there is an implicit assumption in IAS 19 that the specified assumptions represent the best estimate of the eventual outcome of the plan in economic terms, while a requirement to make additional contributions is often a prudent approach designed to build in a risk margin for adverse circumstances. Moreover, when there are no members left in the plan, the minimum funding requirement would have no effect. This would leave the IAS 19 surplus available. To the extent that the entity has a right to this eventual surplus, the IAS 19 surplus would be available to the entity, regardless of the minimum funding restrictions in force at the end of the reporting period. The IFRIC therefore concluded that the existence of a minimum funding requirement may affect the timing of a refund but does not affect whether it is ultimately available to the entity.

The effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions

BC25 The entity's minimum funding requirements at a given date can be analysed into the contributions that are required to cover (a) an existing shortfall for past service on the minimum funding basis and (b) future service.

BC26 Contributions required to cover an existing shortfall may give rise to a liability, as discussed in paragraphs BC31–BC37 below. But they do not affect the availability of a reduction in future contributions for future service.

BC27 In contrast, future contribution requirements in respect of future service do not generate an additional liability at the end of the reporting period because they do not relate to past services received by the entity. However, they may reduce the extent to which the entity can benefit from a reduction in future contributions. Therefore, the IFRIC decided that the available asset from a contribution reduction should be calculated as the present value of the IAS 19 future service cost less the minimum funding contribution requirement in respect of future service in each year.

BC28 If the minimum funding contribution requirement is consistently greater than the IAS 19 future service cost, that calculation may be thought to imply that a liability exists. However, as noted above, an entity has no liability at the end of the reporting period in respect of minimum funding requirements that relate to future service. The economic benefit available from a reduction in future contributions can be nil, but it can never be a negative amount.

BC29 The respondents to D19 were largely supportive of these conclusions.

BC30 The IFRIC noted that future changes to regulations on minimum funding requirements might affect the available surplus. However, the IFRIC decided that, just as the future service cost was determined on the basis of the situation existing at the end of the reporting period , so should the effect of a minimum funding requirement. The IFRIC concluded that when determining the amount of an asset that might be available as a reduction in future contributions, an entity should not consider whether the minimum funding requirement might change in the future. The respondents to D19 were largely supportive of these conclusions.

Prepayments of a minimum funding requirement

BC30A If an entity has prepaid future minimum funding requirement contributions and that prepayment will reduce future contributions, the prepayment generates economic benefits for the entity. However, to the extent that the future minimum funding requirement contributions exceeded future service costs, the original version of IFRIC 14 did not permit entities to consider those economic benefits in measuring a defined benefit asset. After issuing IFRIC 14, the Board reviewed the treatment of such prepayments. The Board concluded that such a prepayment provides an economic benefit to the entity by relieving the entity of an obligation to pay future minimum funding requirement contributions that exceed future service cost. Therefore, considering those economic benefits in measuring a defined benefit asset would convey more useful information to users of financial statements. In May 2009 the Board published that conclusion in an exposure draft *Prepayments of a Minimum Funding Requirement*. After considering the responses to that exposure draft, the Board amended IFRIC 14 by issuing *Prepayments of a Minimum Funding Requirement* in November 2009.

BC30B Some respondents noted that the amendments increase the effect of funding considerations on the measurement of a defined benefit asset and liability and questioned whether funding considerations should ever affect the measurement. However, the Board noted that the sole purpose of the amendments was to eliminate an unintended consequence in IFRIC 14. Thus, the Board did not re-debate the fundamental conclusion of IFRIC 14 that funding is relevant to the measurement when an entity cannot recover the additional cost of a minimum funding requirement in excess of the IAS 19 service cost.

BC30C Many respondents noted that the proposals made the assessment of the economic benefit available from a prepayment different from the assessment for a surplus arising from actuarial gains. Most agreed that a prepayment created an asset, but questioned why the Board did not extend the underlying principle to other surpluses that could be used to reduce future payments of minimum funding requirement contributions.

BC30D The Board did not extend the scope of the amendments to surpluses arising from actuarial gains because such an approach would need further thought and the Board did not want to delay the amendments for prepayments. However, the Board may consider the matter further in a future comprehensive review of pension cost accounting.

Onerous minimum funding requirements

BC31 Minimum funding requirements for contributions to cover an existing minimum funding shortfall create an obligation for the entity at the end of the reporting period because they relate to past service. Nonetheless, usually minimum funding requirements do not affect the measurement of the defined benefit asset or liability under IAS 19. This is because the contributions, once paid, become plan assets and the additional net liability for the funding requirement is nil. However, the IFRIC noted that the limit on the measurement of the defined benefit asset in paragraph ~~58~~64 of IAS 19 may make the funding obligation onerous, as follows.

BC32 If an entity is obliged to make contributions and some or all of those contributions will not subsequently be available as an economic benefit, it follows that when the contributions are made the entity will not be able to recognise an asset to that extent. However, the resulting loss to the entity does not arise on the payment of the contributions but earlier, at the point at which the obligation to pay arises.

BC33 Therefore, the IFRIC concluded that when an entity has an obligation under a minimum funding requirement to make additional contributions to a plan in respect of services already received, the entity should reduce the asset or increase the liability recognised in the statement of financial position to the extent that the minimum funding contributions payable to the plan will not be available to the entity either as a refund or a reduction in future contributions.

BC34 Respondents to D19 broadly supported this conclusion. But some questioned whether the draft Interpretation extended the application of paragraph ~~58~~64 of IAS 19 too far. They argued that it should apply only when an entity has a defined benefit asset. In particular, it should not be used to classify a funding requirement as onerous, thereby creating an additional liability to be recognised beyond that arising from the other requirements of IAS 19. Others agreed that such a liability existed, but questioned whether it fell within the scope of IAS 19 rather than IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

BC35 The IFRIC did not agree that the Interpretation extends the application of paragraph ~~58~~64 of IAS 19. Rather, it applies the principles in IAS 37 relating to onerous contracts in the context of the requirements of IAS 19, including paragraph ~~58~~64. On the question whether the liability falls within the scope of IAS 19 or IAS 37, the IFRIC noted that employee benefits are excluded from the scope of IAS 37. The IFRIC therefore confirmed that the interaction of a minimum funding requirement and the limit on the measurement of the defined benefit asset could result in a decrease in a defined benefit asset or an increase in a defined benefit liability.

BC36 [Deleted]~~The IFRIC also discussed whether the liability in respect of the minimum funding requirement and the effect of any subsequent remeasurement should be recognised immediately in profit or loss or whether they should be eligible for the options for deferred recognition or recognition outside profit or loss that IAS 19 specifies for actuarial gains and losses. The IFRIC noted that the liability in respect of any minimum funding requirements arises only because of the limit on the measurement of the asset recognised in the statement of financial position under paragraph 58 of IAS 19. Furthermore, all consequences of paragraph 58 should be treated consistently.~~

BC37 [Deleted]~~Therefore, the IFRIC concluded that any liability in respect of a minimum funding requirement and the effect of any subsequent remeasurement should be recognised immediately in accordance with paragraph 61(g) or 93C of IAS 19. This is consistent with the recognition of other adjustments to the net asset or liability recognised in the statement of financial position under paragraph 58 of IAS 19. The respondents to D19 broadly agreed with this requirement.~~

Transitional provisions

BC38 In D19, the IFRIC proposed that the draft Interpretation should be applied retrospectively. The draft Interpretation required immediate recognition of all adjustments relating to the minimum funding requirements. The IFRIC therefore argued that retrospective application would be straightforward.

BC39 Respondents to D19 noted that paragraph 58A[*] of IAS 19 causes the limit on the defined benefit asset to affect the deferred recognition of actuarial gains and losses. Retrospective application of the Interpretation could change the amount of that limit for previous periods, thereby also changing the deferred recognition of actuarial gains and losses. Calculating these revised amounts retrospectively over the life of the plan would be costly and of little benefit to users of financial statements.

BC40 The IFRIC agreed with this view. The IFRIC therefore amended the transitional provisions so that IFRIC 14 is to be applied only from the beginning of the first period presented in the financial statements for annual periods beginning on or after the effective date.

Summary of changes from D19

BC41 The Interpretation has been altered in the following significant respects since it was exposed for comment as D19:

(a) The issue of when an entity controls an asset arising from the availability of a refund has been clarified (paragraphs BC10 and BC12);

(b) Requirements relating to the assumptions underlying the measurement of a reduction in future contributions have been clarified (paragraphs BC22 and BC23); and

(c) The transitional requirements have been changed from retrospective application to application from the beginning of the first period presented in the first financial statements to which the Interpretation applies (paragraphs BC38–BC40).

(d) In November 2009 the Board amended IFRIC 14 to require entities to recognise as an economic benefit any prepayment of minimum funding requirement contributions. At the same time, the Board removed references to 'present value' from paragraphs 16, 17, 20 and 22 and 'the surplus in the plan' from paragraph 16 because these references duplicated references in paragraph ~~58~~64 of IAS 19. The Board also amended the term 'future accrual of benefits' to 'future service' for consistency with the rest of IAS 19.

(e) In June 2011 the Board issued an amended IAS 19 that eliminated the deferred recognition of actuarial gains and losses. As a consequence of that amendment, the Board deleted paragraphs 25 and 26, amended paragraphs 1, 6, 17, 24 and amended Examples 1-4 in the illustrative examples accompanying IFRIC 14. As a result of those changes paragraphs BC36 and BC37 of this Basis for Conclusions were deleted and paragraph BC5 was amended. Lastly, cross-references to IAS 19 were updated.

[*] IAS 19 (as amended in June 2011) eliminated deferred recognition of actuarial gains and losses and deleted paragraph 58A.

HK(IFRIC)-Int 16
Revised ~~August 2010~~May 2014

Effective for annual periods
beginning on or after 1 October 2008

HK(IFRIC) Interpretation 16

Hedges of a Net Investment in a Foreign Operation

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

CONTENTS

Hong Kong (IFRIC) Interpretation 16 *Hedges of a Net Investment in a Foreign Operation* (HK(IFRIC)-Int 16) is set out in paragraphs 1–19 and the Appendix. HK(IFRIC)-Int 16 is accompanied by an illustrative example and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 16
Hedges of a Net Investment in a Foreign Operation

References

- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 21 *The Effects of Changes in Foreign Exchange Rates*
- HKAS 39 *Financial Instruments: Recognition and Measurement*

Background

1 Many reporting entities have investments in foreign operations (as defined in HKAS 21 paragraph 8). Such foreign operations may be subsidiaries, associates, joint ventures or branches. HKAS 21 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognise foreign exchange differences in other comprehensive income until it disposes of the foreign operation.

2 Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements.[*] The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.

3 HKAS 39 requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognised in other comprehensive income and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.

4 An entity with many foreign operations may be exposed to a number of foreign currency risks. This Interpretation provides guidance on identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation.

5 HKAS 39 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This Interpretation provides guidance on where, within a group, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting.

6 HKAS 21 and HKAS 39 require cumulative amounts recognised in other comprehensive income relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be reclassified from equity to profit or loss as a reclassification adjustment when the parent disposes of the foreign operation. This Interpretation provides guidance on how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item.

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[*] This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint ventures are accounted for using the equity method~~, financial statements in which venturers' interests in joint ventures are proportionately consolidated (subject to change as proposed in ED 9 *Joint Arrangements* published by the International Accounting Standards Board in September 2007)~~ and financial statements that include a branch or a joint operation as defined in HKFRS 11 *Joint Arrangements*.

HK(IFRIC)-Int 17
Revised ~~July 2012~~May 2014

Effective for annual periods
beginning on or after 1 July 2009

HK(IFRIC) Interpretation 17

Distributions of Non-cash Assets to Owners

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

CONTENTS

Hong Kong (IFRIC) Interpretation 17 *Distributions of Non-cash Assets to Owners* (HK(IFRIC)-Int 17) is set out in paragraphs 1–~~18~~20 and the Appendix. HK(IFRIC)-Int 17 is accompanied by illustrative examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 17
Distributions of Non-cash Assets to Owners

References

- HKFRS 3 *Business Combinations* (as revised in 2008)
- HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
- HKFRS 7 *Financial Instruments: Disclosures*
- HKFRS 10 *Consolidated Financial Statements*
- HKFRS 13 *Fair Value Measurement*
- HKAS 1 *Presentation of Financial Statements* (as revised in 2007)
- HKAS 10 *Events after the Reporting Period*
- ~~HKAS 27 *Consolidated and Separate Financial Statements* (as amended in October 2008)~~

Background

1 Sometimes an entity distributes assets other than cash (non-cash assets) as dividends to its owners* acting in their capacity as owners. In those situations, an entity may also give its owners a choice of receiving either non-cash assets or a cash alternative. Requests had been received for guidance on how an entity should account for such distributions.

2 Hong Kong Financial Reporting Standards (HKFRSs) do not provide guidance on how an entity should measure distributions to its owners (commonly referred to as dividends). HKAS 1 requires an entity to present details of dividends recognised as distributions to owners either in the statement of changes in equity or in the notes to the financial statements.

Scope

3 This Interpretation applies to the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:

(a) distributions of non-cash assets (eg items of property, plant and equipment, businesses as defined in HKFRS 3, ownership interests in another entity or disposal groups as defined in HKFRS 5); and

(b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

4 This Interpretation applies only to distributions in which all owners of the same class of equity instruments are treated equally.

5 This Interpretation does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution. This exclusion applies to the separate, individual and consolidated financial statements of an entity that makes the distribution.

6 In accordance with paragraph 5, this Interpretation does not apply when the non-cash asset is ultimately controlled by the same parties both before and after the distribution. Paragraph B2 of HKFRS 3 states that 'A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its

* Paragraph 7 of HKAS 1 defines owners as holders of instruments classified as equity.

financial and operating policies so as to obtain benefits from its activities.' Therefore, for a distribution to be outside the scope of this Interpretation on the basis that the same parties control the asset both before and after the distribution, a group of individual shareholders receiving the distribution must have, as a result of contractual arrangements, such ultimate collective power over the entity making the distribution.

7 In accordance with paragraph 5, this Interpretation does not apply when an entity distributes some of its ownership interests in a subsidiary but retains control of the subsidiary. The entity making a distribution that results in the entity recognising a non-controlling interest in its subsidiary accounts for the distribution in accordance with ~~HKAS 27 (as amended in 2008)~~HKFRS 10.

8 This Interpretation addresses only the accounting by an entity that makes a non-cash asset distribution. It does not address the accounting by shareholders who receive such a distribution.

Issues

9 When an entity declares a distribution and has an obligation to distribute the assets concerned to its owners, it must recognise a liability for the dividend payable. Consequently, this Interpretation addresses the following issues:

(a) When should the entity recognise the dividend payable?

(b) How should an entity measure the dividend payable?

(c) When an entity settles the dividend payable, how should it account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable?

Conclusions

When to recognise a dividend payable

10 The liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity, which is the date:

(a) when declaration of the dividend, eg by management or the board of directors, is approved by the relevant authority, eg the shareholders, if the jurisdiction requires such approval, or

(b) when the dividend is declared, eg by management or the board of directors, if the jurisdiction does not require further approval.

Measurement of a dividend payable

11 An entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed.

12 If an entity gives its owners a choice of receiving either a non-cash asset or a cash alternative, the entity shall estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative.

13 At the end of each reporting period and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable, with any changes in the carrying amount of the dividend payable recognised in equity as adjustments to the amount of the distribution.

Accounting for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when an entity settles the dividend payable

14 When an entity settles the dividend payable, it shall recognise the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss.

Presentation and disclosures

15 An entity shall present the difference described in paragraph 14 as a separate line item in profit or loss.

16 An entity shall disclose the following information, if applicable:

(a) the carrying amount of the dividend payable at the beginning and end of the period; and

(b) the increase or decrease in the carrying amount recognised in the period in accordance with paragraph 13 as result of a change in the fair value of the assets to be distributed.

17 If, after the end of a reporting period but before the financial statements are authorised for issue, an entity declares a dividend to distribute a non-cash asset, it shall disclose:

(a) the nature of the asset to be distributed;

(b) the carrying amount of the asset to be distributed as of the end of the reporting period; and

(c) the ~~estimated~~ fair value of the asset to be distributed as of the end of the reporting period, if it is different from its carrying amount, and the information about the method(s) used to ~~determine~~measure that fair value required by ~~HKFRS 7 paragraph 27(a) and (b)~~paragraphs 93(b), (d), (g) and (i) and 99 of HKFRS 13.

Effective date

18 An entity shall apply this Interpretation prospectively for annual periods beginning on or after 1 July 2009. Retrospective application is not permitted. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 July 2009, it shall disclose that fact and also apply HKFRS 3 (as revised in 2008), HKAS 27 (as amended in October 2008) and HKFRS 5 (as amended by this Interpretation).

19 HKFRS 10, issued in June 2011, amended paragraph 7. An entity shall apply that amendment when it applies HKFRS 10.

20 HKFRS 13. issued in June 2011, amended paragraph 17. An entity shall apply that amendment when it applies HKFRS 13.

Appendix

Amendments to HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and HKAS 10 *Events after the Reporting Period*

The amendments contained in this appendix when this Interpretation was issued in 2008 have been incorporated into HKFRS 5 and HKAS 10.

Illustrative examples

These examples accompany, but are not part of, IFRIC 17.

Scope of the Interpretation (paragraphs 3–8)

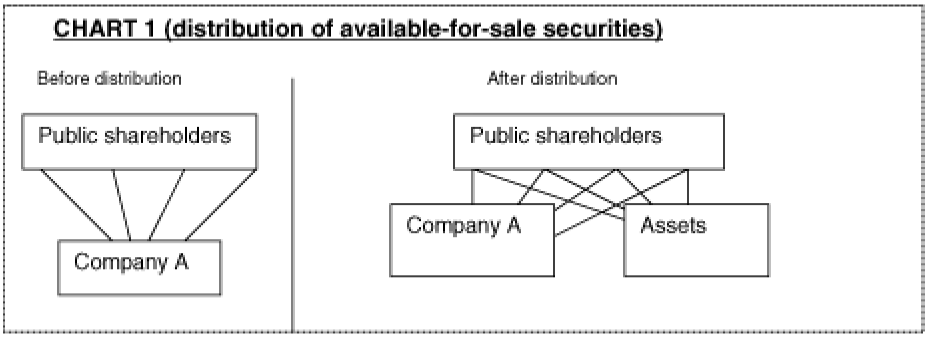

CHART 1 (distribution of available-for-sale securities)

IE1 Assume Company A is owned by public shareholders. No single shareholder controls Company A and no group of shareholders is bound by a contractual agreement to act together to control Company A jointly. Company A distributes certain assets (eg available-for-sale securities) pro rata to the shareholders. This transaction is within the scope of the Interpretation.

IE2 However, if one of the shareholders (or a group bound by a contractual agreement to act together) controls Company A both before and after the transaction, the entire transaction (including the distributions to the non-controlling shareholders) is not within the scope of the Interpretation. This is because in a pro rata distribution to all owners of the same class of equity instruments, the controlling shareholder (or group of shareholders) will continue to control the non-cash assets after the distribution.

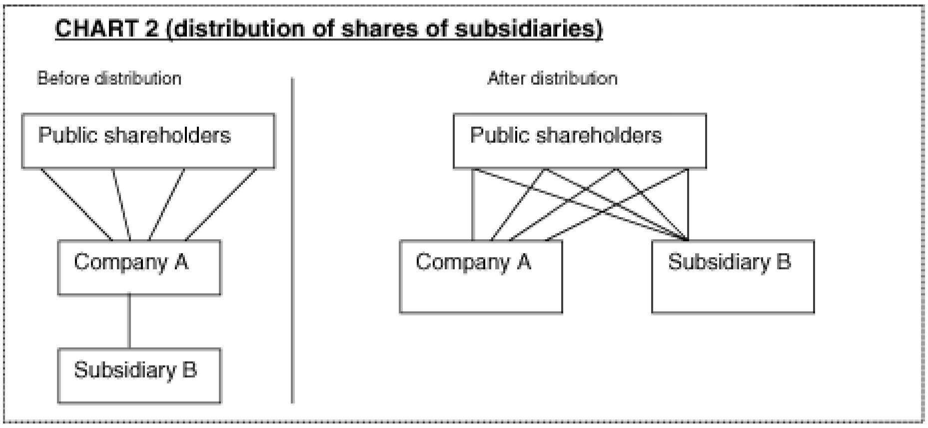

CHART 2 (distribution of shares of subsidiaries)

IE3 Assume Company A is owned by public shareholders. No single shareholder controls Company A and no group of shareholders is bound by a contractual agreement to act together to control Company A jointly. Company A owns all of the shares of Subsidiary B. Company A distributes all of the shares of Subsidiary B pro rata to its shareholders, thereby losing control of Subsidiary B. This transaction is within the scope of the Interpretation.

IE4 However, if Company A distributes to its shareholders shares of Subsidiary B representing only a non-controlling interest in Subsidiary B and retains control of Subsidiary B, the transaction is not within the scope of the Interpretation. Company A accounts for the distribution in accordance with ~~IAS 27~~IFRS 10 *Consolidated ~~and Separate~~ Financial Statements* ~~(as amended in 2008)~~. Company A controls Company B both before and after the transaction.

Basis for Conclusions on IFRIC Interpretation 17 *Distributions of Non-cash Assets to Owners*

This Basis for Conclusions accompanies, but is not part of, IFRIC 17.

HK(IFRIC)-Int 17 is based on IFRIC Interpretation 17 *Distributions of Non-cash Assets to Owners*. In approving HK(IFRIC)-Int 17, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 17. Accordingly, there are no significant differences between HK(IFRIC)-Int 17 and IFRIC Interpretation 17. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 17 referred to below generally correspond with those in HK(IFRIC)-Int 17.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 At present, International Financial Reporting Standards (IFRSs) do not address how an entity should measure distributions to owners acting in their capacity as owners (commonly referred to as dividends). The IFRIC was told that there was significant diversity in practice in how entities measured distributions of non-cash assets.

BC3 The IFRIC published draft Interpretation D23 *Distributions of Non-cash Assets to Owners* for public comment in January 2008 and received 56 comment letters in response to its proposals.

Scope (paragraphs 3–8)

Should the Interpretation address all transactions between an entity and its owners?

BC4 The IFRIC noted that an asset distribution by an entity to its owners is an example of a transaction between an entity and its owners. Transactions between an entity and its owners can generally be categorised into the following three types:

(a) exchange transactions between an entity and its owners.

(b) non-reciprocal transfers of assets by owners of an entity to the entity. Such transfers are commonly referred to as contributions from owners.

(c) non-reciprocal transfers of assets by an entity to its owners. Such transfers are commonly referred to as distributions to owners.

BC5 The IFRIC concluded that the Interpretation should not address exchange transactions between an entity and its owners because that would probably result in addressing all related party transactions. In the IFRIC's view, such a scope was too broad for an Interpretation. Instead, the IFRIC concluded that the Interpretation should focus on distributions of assets by an entity to its owners acting in their capacity as owners.

BC6 In addition, the IFRIC decided that the Interpretation should not address distributions in which owners of the same class of equity instrument are not all treated equally. This is because, in the IFRIC's view, such distributions might imply that at least some of the owners receiving the distributions indeed gave up something to the entity and/or other owners. In other words, such distributions might be more in the nature of exchange transactions.

Should the Interpretation address all types of asset distributions?

BC7 The IFRIC was told that there was significant diversity in the measurement of the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:

(a) distributions of non-cash assets (eg items of property, plant and equipment, businesses as defined in IFRS 3, ownership interests in another entity or disposal groups as defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) to its owners; and

(b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

BC8 The IFRIC noted that all distributions have the same purpose, ie to distribute assets to an entity's owners. It therefore concluded that the Interpretation should address the measurement of all types of asset distributions with one exception set out in paragraph 5 of the Interpretation.

A scope exclusion: a distribution of an asset that is ultimately controlled by the same party or parties before and after the distribution

BC9 In the Interpretation, the IFRIC considered whether it should address how an entity should measure a distribution of an asset (eg an ownership interest in a subsidiary) that is ultimately controlled by the same party or parties before and after the distribution. In many instances, such a distribution is for the purpose of group restructuring (eg separating two different businesses into two different subgroups). After the distribution, the asset is still controlled by the same party or parties.

BC10 In addition, the IFRIC noted that dealing with the accounting for a distribution of an asset within a group would require consideration of how a transfer of any asset within a group should be accounted for in the separate or individual financial statements of group entities.

BC11 For the reasons described in paragraphs BC9 and BC10, the IFRIC concluded that the Interpretation should not deal with a distribution of an asset that is ultimately controlled by the same party or parties before and after the distribution.

BC12 In response to comments received on the draft Interpretation, the IFRIC redeliberated whether the scope of the Interpretation should be expanded to include a distribution of an asset that is ultimately controlled by the same party or parties before and after the distribution. The IFRIC decided not to expand the scope of the Interpretation in the light of the Board's decision to add a project to its agenda to address common control transactions.

BC13 The IFRIC noted that many commentators believed that most distributions of assets to an entity's owners would be excluded from the scope of the Interpretation by paragraph 5. The IFRIC did not agree with this conclusion. It noted that in paragraph B2 of IFRS 3 *Business Combinations* (as revised in 2008), the Board concluded that a group of individuals would be regarded as controlling an entity only when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. In addition, in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* in May 2008, the Board clarified in the amendments to IAS 27 *Consolidated and Separate Financial Statements* that the distribution of equity interests in a new parent to shareholders in exchange for their interests in the existing parent was not a common control transaction[*].

[*] The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statement* issued in May 2011. The accounting requirements for transactions between owners did not change.

BC14 Consequently, the IFRIC decided that the Interpretation should clarify that unless there is a contractual arrangement among shareholders to control the entity making the distribution, transactions in which the shares or the businesses of group entities are distributed to shareholders outside the group (commonly referred to as a spin-off, split-off or demerger) are not transactions between entities or businesses under common control. Therefore they are within the scope of the Interpretation.

BC15 Some commentators on D23 were concerned about situations in which an entity distributes some but not all of its ownership interests in a subsidiary and retains control. They believed that the proposed accounting for the distribution of ownership interests representing a non-controlling interest in accordance with D23 was inconsistent with the requirements of IAS 27 (as amended in 2008). That IFRS requires changes in a parent's ownership interest in a subsidiary that do not result in a loss of control to be accounted for as equity transactions. The IFRIC had not intended the Interpretation to apply to such transactions so did not believe it conflicted with the requirements of IAS 27. As a result of the concerns expressed, the IFRIC amended the Interpretation to make this clear.

BC16 Some commentators on D23 were also concerned about situations in which a subsidiary with a non-controlling interest distributes assets to both the parent and the non-controlling interests. They questioned why only the distribution to the controlling entity is excluded from the scope of the Interpretation. The IFRIC noted that when the parent controls the subsidiary before and after the transaction, the entire transaction (including the distribution to the non-controlling interest) is not within the scope of the Interpretation and is accounted for in accordance with IAS 27.

BC17 Distributions to owners may involve significant portions of an entity's operations. In such circumstances, sometimes referred to as split-off, some commentators on D23 were concerned that it would be difficult to determine which of the surviving entities had made the distribution. They thought that it might be possible for each surviving entity to recognise the distribution of the other. The IFRIC agreed with commentators that identifying the distributing entity might require judgement in some circumstances. However, the IFRIC concluded that the distribution could be recognised in only one entity's financial statements.

When to recognise a dividend payable (paragraph 10) and amendment to IAS 10

BC18 D23 did not address when an entity should recognise a liability for a dividend payable and some respondents asked the IFRIC to clarify this issue. The IFRIC noted that in IAS 10 *Events after the Reporting Period* paragraph 13 states that 'If dividends are declared (ie the dividends are appropriately authorised and no longer at the discretion of the entity) after the reporting period but before the financial statements are authorised for issue, the dividends are not recognised as a liability at the end of the reporting period because no obligation exists at that time'.

BC19 Some commentators stated that in many jurisdictions a commonly held view is that the entity has discretion until the shareholders approve the dividend. Therefore, constituents holding this view believe a conflict exists between 'declared' and the explanatory phrase in the brackets in IAS 10 paragraph 13. This is especially true when the sentence is interpreted as 'declared by *management but before the shareholders' approval*'. The IFRIC concluded that the point at which a dividend is appropriately authorised and no longer at the discretion of the entity will vary by jurisdiction.

BC20 Therefore, as a consequence of this Interpretation the IFRIC decided to recommend that the Board amend IAS 10 to remove the perceived conflict in paragraph 13. The IFRIC also noted that the principle on when to recognise a dividend was in the wrong place within the IASB's authoritative documents. The Board agreed with the IFRIC's conclusions and amended IAS 10 as part of its approval of the Interpretation. The Board confirmed that this Interpretation had not changed the principle on when to recognise a dividend payable; however, the principle was moved from IAS 10 into the Interpretation and clarified but without changing the principle.

How should an entity measure a dividend payable? (paragraphs 11–13)

BC21 IFRSs do not provide guidance on how an entity should measure distributions to owners. However, the IFRIC noted that a number of IFRSs address how a liability should be measured. Although IFRSs do not specifically address how an entity should measure a dividend payable, the IFRIC decided that it could identify potentially relevant IFRSs and apply their principles to determine the appropriate measurement basis.

Which IFRSs are relevant to the measurement of a dividend payable?

BC22 The IFRIC considered all IFRSs that prescribe the accounting for a liability. Of those, the IFRIC concluded that IAS 37 *Provisions, Contingent Assets and Contingent Liabilities* and IAS 39 *Financial Instruments: Recognition and Measurement* were the most likely to be relevant. The IFRIC concluded that other IFRSs were not applicable because most of them addressed only liabilities arising from exchange transactions and some of them were clearly not relevant (eg IAS 12 *Income Taxes*). As mentioned above, the Interpretation addresses only non-reciprocal distributions of assets by an entity to its owners.

BC23 Given that all types of distributions have the purpose of distributing assets to owners, the IFRIC decided that all dividends payable should be measured the same way, regardless of the types of assets to be distributed. This also ensures that all dividends payable are measured consistently.

BC24 Some believed that IAS 39 was the appropriate IFRS to be used to measure dividends payable. They believed that, once an entity declared a distribution to its owners, it had a contractual obligation to distribute the assets to its owners. However, IAS 39 would not cover dividends payable if they were considered to be non-contractual obligations. In addition, IAS 39 covers some but not all obligations that require an entity to deliver non-cash assets to another entity. It does not cover a liability to distribute non-financial assets to owners. The IFRIC therefore concluded that it was not appropriate to conclude that all dividends payable should be within the scope of IAS 39.

BC25 The IFRIC then considered IAS 37, which is generally applied in practice to determine the accounting for liabilities other than those arising from executory contracts and those addressed by other IFRSs. IAS 37 requires an entity to measure a liability on the basis of the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Consequently, in D23 the IFRIC decided that it was appropriate to apply the principles in IAS 37 to all dividends payable (regardless of the types of assets to be distributed). The IFRIC decided that to apply IAS 37 to measure a liability for an obligation to distribute non-cash assets to owners, an entity should consider the fair value of the assets to be distributed. The fair value of the assets to be distributed is clearly relevant no matter which approach in IAS 37 is taken to determine the best estimate of the expenditure required to settle the liability.

BC26 However, in response to comments received on D23, the IFRIC reconsidered whether the Interpretation should specify that all dividends payable should be measured in accordance with IAS 37. The IFRIC noted that many respondents were concerned that D23 might imply that the measurement attribute in IAS 37 should always be interpreted to be fair value. This was not the intention of D23 as that question is part of the Board's project to amend IAS 37. In addition, many respondents were not certain whether measuring the dividend payable 'by reference to' the fair value of the assets to be distributed required measurement at their fair value or at some other amount.

BC27 Therefore, the IFRIC decided to modify the proposal in D23 to require the dividend payable to be measured at the fair value of the assets to be distributed, without linking to any individual standard its conclusion that fair value is the most relevant measurement attribute. The IFRIC also noted that if the assets being distributed constituted a business, its fair value could be different from the simple sum of the fair value of the component assets and liabilities (ie it includes the value of goodwill or the identified intangible assets).

Should any exception be made to the principle of measuring a dividend payable at the fair value of the assets to be distributed?

BC28 Some are concerned that the fair value of the assets to be distributed might not be reliably measurable in all cases. They believe that exceptions should be made in the following circumstances:

(a) An entity distributes an ownership interest of another entity that is not traded in an active market and the fair value of the ownership interest cannot be measured reliably. The IFRIC noted that IAS 39 does not permit investments in equity instruments that do not have a quoted market price in an active market[*] and whose fair value cannot be measured reliably to be measured at fair value.

(b) An entity distributes an intangible asset that is not traded in an active market and therefore would not be permitted to be carried at a revalued amount in accordance with IAS 38 *Intangible Assets*.

BC29 The IFRIC noted that in accordance with IAS 39 paragraphs AG80 and AG81, the fair value of equity instruments that do not have a quoted price in an active market[†] is reliably measurable if:

(a) the variability in the range of reasonable fair value estimates is not significant for that instrument, or

(b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

BC30 The IFRIC noted that, when the management of an entity recommends a distribution of a non-cash asset to its owners, one or both of the conditions for determining a reliable measure of the fair value of equity instruments that do not have a quoted price in an active market is likely to be satisfied. Management would be expected to know the fair value of the asset because management has to ensure that all owners of the entity are informed of the value of the distribution. For this reason, it would be difficult to argue that the fair value of the assets to be distributed cannot be determined reliably.

BC31 In addition, the IFRIC recognised that in some cases the fair value of an asset must be estimated. As mentioned in paragraph 86 of the *Framework for the Preparation and Presentation of Financial Statements*[#], the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

BC32 The IFRIC noted that a reason why IAS 38 and IAS 39 require some assets to be measured using a historical cost basis is cost-benefit considerations. The cost of determining the fair value of an asset not traded in an active market at the end of each reporting period could outweigh the benefits. However, because an entity would be required to determine the fair value of the assets to be distributed only once at the time of distribution, the IFRIC concluded that the benefit (ie informing users of the financial statements of the value of the assets distributed) outweighs the cost of determining the fair value of the assets.

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* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 refers to unquoted equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

† IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 refers to unquoted equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

now paragraph 4.1 of the *Conceptual Framework*. References to the *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

BC33 Furthermore, the IFRIC noted that dividend income, regardless of whether it is in the form of cash or non-cash assets, is within the scope of IAS 18 *Revenue* and is required to be measured at the fair value of the consideration received. Although the Interpretation does not address the accounting by the recipient of the non-cash distribution, the IFRIC concluded that the Interpretation did not impose a more onerous requirement on the entity that makes the distribution than IFRSs have already imposed on the recipient of the distribution.

BC34 For the reasons described in paragraphs BC28–BC33, the IFRIC concluded that no exceptions should be made to the requirement that the fair value of the asset to be distributed should be used in measuring a dividend payable.

Whether an entity should remeasure the dividend payable (paragraph 13)

BC35 The IFRIC noted that paragraph 59 of IAS 37 requires an entity to review the carrying amount of a liability at the end of each reporting period and to adjust the carrying amount to reflect the current best estimate of the liability. Other IFRSs such as IAS 19 *Employee Benefits* similarly require liabilities that are based on estimates to be adjusted each reporting period. The IFRIC therefore decided that the entity should review and adjust the carrying amount of the dividend payable to reflect its current best estimate of the fair value of the assets to be distributed at the end of each reporting period and at the date of settlement.

BC36 The IFRIC concluded that, because any adjustments to the best estimate of the dividend payable reflect changes in the estimated value of the distribution, they should be recognised as adjustments to the amount of the distribution. In accordance with IAS 1 *Presentation of Financial Statements* (as revised in 2007), distributions to owners are required to be recognised directly in the statement of changes in equity. Similarly, adjustments to the amount of the distribution are also recognised directly in the statement of changes in equity.

BC37 Some commentators argued that the changes in the estimated value of the distribution should be recognised in profit or loss because changes in liabilities meet the definition of income or expenses in the *Framework*. However, the IFRIC decided that the gain or loss on the assets to be distributed should be recognised in profit or loss when the dividend payable is settled. This is consistent with other IFRSs (IAS 16, IAS 38, IAS 39) that require an entity to recognise in profit or loss any gain or loss arising from derecognition of an asset. The IFRIC concluded that the changes in the dividend payable before settlement related to changes in the estimate of the distribution and should be accounted for in equity (ie adjustments to the amount of the distribution) until settlement of the dividend payable.

When the entity settles the dividend payable, how should it account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable? (paragraph 14)

BC38 When an entity distributes the assets to its owners, it derecognises both the assets distributed and the dividend payable.

BC39 The IFRIC noted that, at the time of settlement, the carrying amount of the assets distributed would not normally be greater than the carrying amount of the dividend payable because of the recognition of impairment losses required by other applicable standards. For example, paragraph 59 of IAS 36 *Impairment of Assets* requires an entity to recognise an impairment loss in profit or loss when the recoverable amount of an asset is less than its carrying amount. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use in accordance with paragraph 6 of IAS 36. When an entity has an obligation to distribute the asset to its owners in the near future, it would not seem appropriate to measure an impairment loss using the asset's value in use. Furthermore, IFRS 5 requires an entity to measure an asset held for sale at the lower of its carrying amount and its fair value less costs to sell. Consequently, the IFRIC concluded that when an entity derecognises the dividend payable and the asset distributed, any difference will always be a credit balance (referred to below as the credit balance).

BC40 In determining how the credit balance should be accounted for, the IFRIC first considered whether it should be recognised as an owner change in equity.

BC41 The IFRIC acknowledged that an asset distribution was a transaction between an entity and its owners. The IFRIC also observed that distributions to owners are recognised as owner changes in equity in accordance with IAS 1 (as revised in 2007). However, the IFRIC noted that the credit balance did not arise from the distribution transaction. Rather, it represented the cumulative unrecognised gain associated with the asset. It reflects the performance of the entity during the period the asset was held until it was distributed.

BC42 Some might argue that, since an asset distribution does not result in the owners of an entity losing the future economic benefits of the asset, the credit balance should be recognised directly in equity. This view would be based upon the proprietary perspective in which the reporting entity does not have substance of its own separate from that of its owners. However, the IFRIC noted that the *Framework* requires an entity to consider the effect of a transaction from the perspective of the entity for which the financial statements are prepared. Under the entity perspective, the reporting entity has substance of its own, separate from that of its owners. In addition, when there is more than one class of equity instruments, the argument that all owners of an entity have effectively the same interest in the asset would not be valid.

BC43 For the reasons described in paragraphs BC41 and BC42, the IFRIC concluded that the credit balance should not be recognised as an owner change in equity.

BC44 The IFRIC noted that, as explained in the Basis for Conclusions on IAS 1, the Board explicitly prohibited any income or expenses (ie non-owner changes in equity) from being recognised directly in the statement of changes in equity. Any such income or expenses must be recognised as items of comprehensive income first.

BC45 The statement of comprehensive income in accordance with IAS 1 includes two components: items of profit or loss, and items of other comprehensive income. The IFRIC therefore discussed whether the credit balance should be recognised in profit or loss or in other comprehensive income.

BC46 IAS 1 does not provide criteria for when an item should be recognised in profit or loss. However, paragraph 88 of IAS 1 states: ‘An entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise.’

BC47 The IFRIC considered the circumstances in which IFRSs require items of income and expense to be recognised as items of other comprehensive income, mainly as follows:

(a) some actuarial gains or losses arising from remeasuring defined benefit liabilities provided that specific criteria set out in IAS 19 are met.

(b) a revaluation surplus arising from revaluation of an item of property, plant and equipment in accordance with IAS 16 or revaluation of an intangible asset in accordance with IAS 38.

(c) an exchange difference arising from the translation of the results and financial positions of an entity from its functional currency into a presentation currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

(d) an exchange difference arising from the translation of the results and financial position of a foreign operation into a presentation currency of a reporting entity for consolidation purposes in accordance with IAS 21.

(e) a change in the fair value of an available-for-sale investment in accordance with IAS 39.

(f) a change in the fair value of a hedging instrument qualifying for cash flow hedge accounting in accordance with IAS 39.

BC48 The IFRIC concluded that the requirement in IAS 1 prevents any of these items from being applied by analogy to the credit balance. In addition, the IFRIC noted that, with the exception of the items described in paragraph BC47(a)–(c), the applicable IFRSs require the items of income and expenses listed in paragraph BC47 to be reclassified to profit or loss when the related assets or liabilities are derecognised. Those items of income and expenses are recognised as items of other comprehensive income when incurred, deferred in equity until the related assets are disposed of (or the related liabilities are settled), and reclassified to profit or loss at that time.

BC49 The IFRIC noted that, when the dividend payable is settled, the asset distributed is also derecognised. Therefore, given the existing requirements in IFRSs, even if the credit balance were recognised as an item of other comprehensive income, it would have to be reclassified to profit or loss immediately. As a result, the credit balance would appear three times in the statement of comprehensive income—once recognised as an item of other comprehensive income, once reclassified out of other comprehensive income to profit or loss and once recognised as an item of profit or loss as a result of the reclassification. The IFRIC concluded that such a presentation does not faithfully reflect what has occurred. In addition, users of financial statements were likely to be confused by such a presentation.

BC50 Moreover, when an entity distributes its assets to its owners, it loses the future economic benefit associated with the assets distributed and derecognises those assets. Such a consequence is, in general, similar to that of a disposal of an asset. IFRSs (eg IAS 16, IAS 38, IAS 39 and IFRS 5) require an entity to recognise in profit or loss any gain or loss arising from the derecognition of an asset. IFRSs also require such a gain or loss to be recognised when the asset is derecognised. As mentioned in paragraph BC42, the *Framework* requires an entity to consider the effect of a transaction from the perspective of an entity for which the financial statements are prepared. For these reasons, the IFRIC concluded that the credit balance and gains or losses on derecognition of an asset should be accounted for in the same way.

BC51 Furthermore, paragraph 92 of the *Framework*[*] states: 'Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or *a decrease of a liability* has arisen that can be measured reliably' (emphasis added). At the time of the settlement of a dividend payable, there is clearly a decrease in a liability. Therefore, the credit balance should be recognised in profit or loss in accordance with paragraph 92 of the *Framework*. Some might argue that the entity does not receive any additional economic benefits when it distributes the assets to its owners. As mentioned in paragraph BC41, the credit balance does not represent any additional economic benefits to the entity. Instead, it represents the unrecognised economic benefits that the entity obtained while it held the assets.

BC52 The IFRIC also noted that paragraph 55 of the *Framework*[†] states: 'The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be: (a) used singly or in combination with other assets in the production of goods or services to be sold by the entity; (b) exchanged for other assets; (c) used to settle a liability; or (d) *distributed to the owners of the entity* [emphasis added].'

BC53 In the light of these requirements, in D23 the IFRIC concluded that the credit balance should be recognised in profit or loss. This treatment would give rise to the same accounting results regardless of whether an entity distributes non-cash assets to its owners, or sells the non-cash assets first and distributes the cash received to its owners. Most commentators on D23 supported the IFRIC's conclusion and its basis.

BC54 Some IFRIC members believed that it would be more appropriate to treat the distribution as a single transaction with owners and therefore recognise the credit balance directly in equity. This alternative view was included in D23 and comments were specifically invited. However, this view was not supported by commentators. To be recognised directly in equity, the credit balance must be considered an owner change in equity in accordance with IAS 1. The IFRIC decided that the credit balance does not arise from the distribution transaction. Rather, it represents the increase in value of the assets. The increase in the value of the asset does not meet the definition of an owner change in equity in accordance with IAS 1. Rather, it meets the definition of income and should be recognised in profit and loss.

[*] now paragraph 4.47 of the *Conceptual Framework*
[†] now paragraph 4.10 of the *Conceptual Framework*

BC55 The IFRIC recognised respondents' concerns about the potential 'accounting mismatch' in equity resulting from measuring the assets to be distributed at carrying amount and measuring the dividend payable at fair value. Consequently, the IFRIC considered whether it should recommend that the Board amend IFRS 5 to require the assets to be distributed to be measured at fair value.

BC56 In general, IFRSs permit remeasurement of assets only as the result of a transaction or an impairment. The exceptions are situations in which the IFRSs prescribe current measures on an ongoing basis as in IASs 39 and 41 *Agriculture*, or permit them as accounting policy choices as in IASs 16, 38 and 40 *Investment Property*. As a result of its redeliberations, the IFRIC concluded that there was no support in IFRSs for requiring a remeasurement of the assets because of a decision to distribute them. The IFRIC noted that the mismatch concerned arises only with respect to assets that are not carried at fair value already. The IFRIC also noted that the accounting mismatch is the inevitable consequence of IFRSs using different measurement attributes at different times with different triggers for the remeasurement of different assets and liabilities.

BC57 If a business is to be distributed, the fair value means the fair value of the business to be distributed. Therefore, it includes goodwill and intangible assets. However, internally generated goodwill is not permitted to be recognised as an asset (paragraph 48 of IAS 38). Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance are not permitted to be recognised as intangible assets (paragraph 63 of IAS 38). In accordance with IAS 38, the carrying amounts of internally generated intangible assets are generally restricted to the sum of expenditure incurred by an entity. Consequently, a requirement to remeasure an asset that is a business would contradict the relevant requirements in IAS 38.

BC58 Furthermore, in addition to the lack of consistency with other IFRSs, changing IFRS 5 this way (ie to require an asset held for distribution to owners to be remeasured at fair value) would create internal inconsistency within IFRS 5. There would be no reasonable rationale to explain why IFRS 5 could require assets that are to be sold to be carried at the lower of fair value less costs to sell and carrying value but assets to be distributed to owners to be carried at fair value. The IFRIC also noted that this 'mismatch' would arise only in the normally short period between when the dividend payable is recognised and when it is settled. The length of this period would often be within the control of management. Therefore, the IFRIC decided not to recommend that the Board amend IFRS 5 to require assets that are to be distributed to be measured at fair value.

Amendment to IFRS 5

BC59 IFRS 5 requires an entity to classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. IFRS 5 also sets out presentation and disclosure requirements for a discontinued operation.

BC60 When an entity has an obligation to distribute assets to its owners, the carrying amount of the assets will no longer be recovered principally through continuing use. The IFRIC decided that the information required by IFRS 5 is important to users of financial statements regardless of the form of a transaction. Therefore, the IFRIC concluded that the requirements in IFRS 5 applicable to non-current assets (or disposal groups) classified as held for sale and to discontinued operations should also be applied to assets (or disposal groups) held for distribution to owners.

BC61 However, the IFRIC concluded that requiring an entity to apply IFRS 5 to non-current assets (disposal groups) held for distribution to owners would require amendments to IFRS 5. This is because, in the IFRIC's view, IFRS 5 at present applies only to non-current assets (disposal groups) held for sale.

BC62 The Board discussed the IFRIC's proposal at its meeting in December 2007. The Board agreed with the IFRIC's conclusion that IFRS 5 should be amended to apply to non-current assets held for distribution to owners as well as to assets held for sale. However, the Board noted that IFRS 5 requires an entity to classify a non-current asset as held for sale when the sale is highly probable and the entity is *committed* to a plan to sell (emphasis added). Consequently, the Board directed the IFRIC to invite comments on the following questions:

(a) Should an entity apply IFRS 5 when it is committed to make a distribution or when it has an obligation to distribute the assets concerned?

(b) Is there a difference between those dates?

(c) If respondents believe that there is a difference between the dates and that an entity should apply IFRS 5 at the commitment date, what is the difference? What indicators should be included in IFRS 5 to help an entity to determine that date?

BC63 On the basis of the comments received, the IFRIC noted that, in many jurisdictions, shareholders' approval is required to make a distribution. Therefore, in such jurisdictions there could be a difference between the commitment date (ie the date when management is committed to the dividend) and the obligation date (ie the date when the dividend is approved by the shareholders). On the other hand, some commentators think that, when a distribution requires shareholders' approval, the entity cannot be committed until that approval is obtained: in that case, there would be no difference between two dates.

BC64 The IFRIC concluded that IFRS 5 should be applied at the commitment date at which time the assets must be available for immediate distribution in their present condition and the distribution must be *highly probable*. For the distribution to be highly probable, it should meet essentially the same conditions required for assets held for sale. Further, the IFRIC concluded that the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable. The IFRIC noted that shareholder approval is also required for the sale of assets in some jurisdictions and concluded that similar consideration of the probability of such approval should be required for assets held for sale.

BC65 The Board agreed with the IFRIC's conclusions and amended IFRS 5 as part of its approval of the Interpretation.

Summary of main changes from the draft Interpretation

BC66 The main changes from the IFRIC's proposals in D23 are as follows:

(a) Paragraphs 3–8 were modified to clarify the scope of the Interpretation.

(b) Paragraph 10 clarifies when to recognise a dividend payable.

(c) Paragraphs 11–13 were modified to require the dividend payable to be measured at the fair value of the assets to be distributed without linking the IFRIC's conclusion that fair value is the most relevant measurement attribute to any individual standard.

(d) Illustrative examples were expanded to set out clearly the scope of the Interpretation.

(e) The Interpretation includes the amendments to IFRS 5 and IAS 10.

(f) The Basis for Conclusions was changed to set out more clearly the reasons for the IFRIC's conclusions.

HK(IFRIC)-Int 19
~~Issued December 2009~~Revised May 2014

Effective for annual periods
beginning on or after 1 July 2010

HK(IFRIC) Interpretation 19

Extinguishing Financial Liabilities with Equity Instruments

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

CONTENTS

Hong Kong (IFRIC) Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments* (HK(IFRIC)-Int 19) is set out in paragraphs 1–~~13~~15 and the Appendix. HK(IFRIC)-Int 19 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*

References

- *Framework for the Preparation and Presentation of Financial Statements*[*]
- HKFRS 2 *Share-based Payment*
- HKFRS 3 (Revised) *Business Combinations*
- HKFRS 13 *Fair Value Measurement*
- HKAS 1 *Presentation of Financial Statements*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 32 *Financial Instruments: Presentation*
- HKAS 39 *Financial Instruments: Recognition and Measurement*

Background

1 A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'. The International Financial Reporting Interpretations Committee has received requests for guidance on the accounting for such transactions.

Scope

2 This Interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

3 An entity shall not apply this Interpretation to transactions in situations where:

(a) the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.

(b) the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.

(c) extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

[*] In October 2010 the HKICPA replaced the *Framework* with the *Conceptral Framework for Financial Reporting*.

Issues

4 This Interpretation addresses the following issues:

(a) Are an entity's equity instruments issued to extinguish all or part of a financial liability 'consideration paid' in accordance with paragraph 41 of HKAS 39?

(b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability?

(c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

Conclusions

5 The issue of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 41 of HKAS 39. An entity shall remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished in accordance with paragraph 39 of HKAS 39.

6 When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

7 If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph ~~49~~47 of ~~HKAS 39~~HKFRS 13 is not applied.

8 If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.

9 The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognised in profit or loss, in accordance with paragraph 41 of HKAS 39. The equity instruments issued shall be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished.

10 When only part of the financial liability is extinguished, consideration shall be allocated in accordance with paragraph 8. The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 40 of HKAS 39.

11 An entity shall disclose a gain or loss recognised in accordance with paragraphs 9 and 10 as a separate line item in profit or loss or in the notes.

Effective date and transition

12 An entity shall apply this Interpretation for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 July 2010, it shall disclose that fact.

13 An entity shall apply a change in accounting policy in accordance with HKAS 8 from the beginning of the earliest comparative period presented.

14 [*This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition*.]

15 HKFRS 13, issued in June 2011, amended paragraph 7. An entity shall apply that amendment when it applies HKFRS 13.

Appendix
Amendment to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

The amendment in this appendix shall be applied for annual periods beginning on or after 1 July 2010. If an entity applies this Interpretation for an earlier period, these amendments shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Interpretation was issued have been incorporated into the relevant Standard.

Basis for Conclusions on HK(IFRIC)-Int 19

This Basis for Conclusions accompanies, but is not part of, IFRIC 19.

HK(IFRIC)-Int 19 is based on IFRIC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*. In approving HK(IFRIC)-Int 19, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 19. Accordingly, there are no significant differences between HK(IFRIC)-Int 19 and IFRIC Interpretation 19. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 19 referred to below generally correspond with those in HK(IFRIC)-Int 19.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC received a request for guidance on the application of IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Presentation* when an entity issues its own equity instruments to extinguish all or part of a financial liability. The question is how the entity should recognise the equity instruments issued.

BC3 The IFRIC noted that lenders manage loans to entities in financial difficulty in a variety of ways including one or more of the following:

(a) selling the loans in the market to other investors/lenders;

(b) renegotiating the terms of the loan (eg extension of the maturity date or lower interest payments); or

(c) accepting the creditor's equity instruments in full or partial settlement of the liability (sometimes referred to as a 'debt for equity swap').

BC4 The IFRIC was informed that there was diversity in practice in how entities measure the equity instruments issued in full or partial settlement of a financial liability following renegotiation of the terms of the liability. Some recognise the equity instruments at the carrying amount of the financial liability and do not recognise any gain or loss in profit or loss. Others recognise the equity instruments at the fair value of either the liability extinguished or the equity instruments issued and recognise a difference between that amount and the carrying amount of the financial liability in profit or loss.

BC5 In August 2009 the IFRIC published draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* for public comment. It received 33 comment letters in response to the proposals.

Scope

BC6 The IFRIC concluded that its Interpretation should address only the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish part or all of the liability. It does not address the accounting by the creditor because other IFRSs already set out the relevant requirements.

BC7 The IFRIC considered whether to provide guidance on transactions in which the creditor is also a direct or indirect shareholder and is acting in its capacity as an existing direct or indirect shareholder. The IFRIC concluded that the Interpretation should not address such transactions. It noted that determining whether the issue of equity instruments to extinguish a financial liability in such situations is considered a transaction with an owner in its capacity as an owner would be a matter of judgement depending on the facts and circumstances.

BC8 In its redeliberations, the IFRIC clarified that transactions when the creditor and the entity are controlled by the same party or parties before and after the transaction are outside the scope of the Interpretation when the substance of the transaction includes an equity distribution by, or contribution to, the entity. The IFRIC acknowledged that the allocation of consideration between the extinguishment of all or part of a financial liability and the equity distribution or contribution components may not always be reliably measured.

BC9 Some respondents questioned whether the Interpretation should be applied to transactions when the extinguishment of the financial liability by issuing equity shares is in accordance with the original terms of the liability. In its redeliberations the IFRIC decided that these transactions should be excluded from the scope of the Interpretation, noting that IAS 32 includes specific guidance on those financial instruments.

Are an entity's equity instruments 'consideration paid'?

BC10 The IFRIC noted that IFRSs do not contain specific guidance on the measurement of an entity's equity instruments issued to extinguish all or part of a financial liability. Paragraph 41 of IAS 39 requires an entity to recognise in profit or loss the difference between the carrying amount of the financial liability extinguished and the consideration paid. That paragraph describes 'consideration paid' as including non-cash assets transferred, or liabilities assumed, and does not specifically mention equity instruments issued. Consequently, some are of the view that equity instruments are not 'consideration paid'.

BC11 Holders of this view believe that, because IFRSs are generally silent on how to measure equity instruments on initial recognition (see paragraph BC15), a variety of practices has developed. One such practice is to recognise the equity instruments issued at the carrying amount of the financial liability extinguished.

BC12 However, the IFRIC observed that both IFRS 2 *Share-based Payment* and IFRS 3 *Business Combinations* make it clear that equity instruments are used as consideration to acquire goods and services as well as to obtain control of businesses.

BC13 The IFRIC also observed that the issue of equity instruments to extinguish a financial liability could be analysed as consisting of two transactions—first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability.

BC14 As a result of its analysis, the IFRIC concluded that the equity instruments issued to extinguish a financial liability are 'consideration paid' in accordance with paragraph 41 of IAS 39.

How should the equity instruments be measured?

BC15 The IFRIC observed that although IFRSs do not contain a general principle for the initial recognition and measurement of equity instruments, guidance on specific transactions exists, including:

(a) *initial recognition of compound instruments* (IAS 32). The amount allocated to the equity component is the residual after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

(b) *cost of equity transactions and own equity instruments ('treasury shares') acquired and reissued or cancelled* (IAS 32). No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. These are transactions with an entity's owners in their capacity as owners.

(c) *equity instruments issued in share-based payment transactions* (IFRS 2). For equity-settled share-based payment transactions, the entity measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received (eg transactions with employees), the entity measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

(d) *consideration transferred in business combinations* (IFRS 3). The total consideration transferred in a business combination is measured at fair value. It includes the acquisition-date fair values of any equity interests issued by the acquirer.

BC16 The IFRIC noted that the general principle of IFRSs is that equity is a residual and should be measured initially by reference to changes in assets and liabilities (the *Framework*[*] and IFRS 2). IFRS 2 is clear that when goods or services are received in return for the issue of equity instruments, the increase in equity is measured directly at the fair value of the goods or services received.

BC17 The IFRIC decided that the same principles should apply when equity instruments are issued to extinguish financial liabilities. However, the IFRIC was concerned that entities might encounter practical difficulties in measuring the fair value of both the equity instruments issued and the financial liability, particularly when the entity is in financial difficulty. Therefore, the IFRIC decided in D25 that equity instruments issued to extinguish a financial liability should be measured initially at the fair value of the equity instruments issued or the fair value of the liability extinguished, whichever is more reliably determinable.

BC18 However, in response to comments received on D25, the IFRIC reconsidered whether the entity should initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued or the fair value of the liability extinguished. The IFRIC noted that many respondents proposed that a preferred measurement basis should be determined to avoid an 'accounting choice' developing in practice, acknowledging that both measurement approaches would need to be used to identify which was more reliably determinable.

BC19 Therefore the IFRIC decided to modify the proposal in D25 and identify a preferred measurement basis. In identifying this preferred measurement basis, the IFRIC noted that many respondents considered that the principles in IFRS 2 and the *Framework* referred to in paragraph BC16 support a measurement based on the fair value of the liability extinguished.

BC20 However, some respondents argued that the fair value of the equity issued should be the proposed measurement basis. They pointed out that this approach would be consistent with the consensus that the issue of an entity's equity instruments is consideration paid in accordance with paragraph 41 of IAS 39. They also argued that the fair value of the equity issued best reflects the total amount of consideration paid in the transaction, which may include a premium that the creditor requires to renegotiate the terms of the financial liability.

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

BC21 The IFRIC considered that the fair value of the equity issued should be the proposed measurement basis for the reasons described in paragraph BC20. Consequently the IFRIC concluded that an entity should initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured. If the fair value of the equity instruments issued cannot be reliably measured then these equity instruments should initially be measured to reflect the fair value of the liability extinguished.

BC22 In redeliberations, the IFRIC noted that these transactions often take place in situations when the terms of the financial liability are breached and the liability becomes repayable on demand. The IFRIC agreed with comments received that paragraph 49 of IAS 39 is not applied in measuring the fair value of all or part of a financial liability extinguished in these situations. This is because the extinguishment transaction suggests that the demand feature is no longer substantive.

BC23 In response to comments, the IFRIC also clarified that the equity instruments issued should be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished. This is consistent with paragraphs BC341 and BC342 of the Basis for Conclusions on IFRS 3, which discuss the views on whether equity instruments issued as consideration in a business combination should be measured at fair value at the agreement date or acquisition date, concluding that measurement should be at the acquisition date.

How should a difference between the carrying amount of the financial liability and the consideration paid be accounted for?

BC24 In accordance with paragraph 41 of IAS 39, the entity should recognise a gain or loss in profit or loss for any difference between the carrying amount of the financial liability extinguished and the consideration paid. This requirement is consistent with the *Framework*'s discussion of income:

(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or *decreases of liabilities that result in increases in equity*, other than those relating to contributions from equity participants. (paragraph 70(a))[*] (emphasis added)

(b) Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits ... (paragraph 75)[†]

(c) Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan. (paragraph 77)[#]

Full extinguishment

BC25 The IFRIC noted that, as discussed in paragraph BC13, a transaction in which an entity issues equity instruments to extinguish a liability can be analysed as first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability. Consistently with paragraph BC24, when the creditor accepts cash to extinguish the liability, the entity should recognise a gain or loss in profit or loss.

* now paragraph 4.25(a) of the *Conceptual Framework*
† now paragraph 4.30 of the *Conceptual Framework*
# now paragraph 4.32 of the *Conceptual Framework*

BC26 Similarly, the IFRIC noted that, in accordance with IAS 32, when an entity amends the terms of a convertible instrument to induce early conversion, the entity recognises in profit or loss the fair value of any additional consideration paid to the holder. Thus, the IFRIC concluded that when an entity settles an instrument by issuing its own equity instruments and that settlement is not in accordance with the original terms of the financial liability, the entity should recognise a gain or loss in profit or loss.

BC27 As a result of its conclusions, the IFRIC decided that the entity should recognise a gain or loss in profit or loss. This gain or loss is equal to the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued, or fair value of the liability extinguished if the fair value of the equity instruments issued cannot be reliably measured.

Partial extinguishment

BC28 The IFRIC also observed that the restructuring of a financial liability can involve both the partial settlement of the liability by the issue of equity instruments to the creditor and the modification of the terms of the liability that remains outstanding. Therefore, the IFRIC decided that the Interpretation should also apply to partial extinguishments. In the case of a partial extinguishment, the discussion in paragraphs BC25–BC27 applies to the part of the liability extinguished.

BC29 Many respondents requested clarification of the guidance on partial extinguishment included in D25. During its redeliberations, the IFRIC acknowledged that the issue of an entity's equity shares may reflect consideration paid for both the extinguishment of part of a financial liability and the modification of the terms of the part of the liability that remains outstanding.

BC30 The IFRIC decided that to reflect this, an entity should allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity would consider this allocation in determining the profit or loss to be recognised on the part of the liability extinguished and in its assessment of whether the terms of the remaining liability have been substantially modified.

BC31 The IFRIC concluded that providing additional guidance on determining whether the terms of the part of the financial liability that remains outstanding has been substantially modified in accordance with paragraph 40 of IAS 39 was outside the scope of the Interpretation.

Presentation

BC32 The IFRIC decided that an entity should disclose the gain or loss on the extinguishment of the financial liability by the issue of equity instruments as a separate line item in profit or loss or in the notes. This requirement is consistent with the *Framework* and the requirements in other IFRSs, for example:

(a) When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. (paragraph 76 of the *Framework*)[*]

(b) An entity shall present additional line items, headings and subtotals in the statement of comprehensive income and the separate income statement (if presented), when such presentation is relevant to an understanding of the entity's financial performance. (paragraph 85 of IAS 1 *Presentation of Financial Statements*)

[*] now paragraph 4.31 of the *Conceptual Framework*

(c) An entity shall disclose net gains or net losses on financial liabilities either in the statement of comprehensive income or in the notes. (paragraph 20 of IFRS 7 *Financial Instruments: Disclosures*)

Transition

BC33 The IFRIC decided that the Interpretation should be applied retrospectively even though it acknowledged that determining fair values retrospectively may be problematic. The IFRIC noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides guidance on circumstances in which retrospective application might be impracticable. The IFRIC concluded that it was preferable to require entities that could apply the Interpretation retrospectively to do so, rather than requiring all entities to apply it prospectively to future transactions. However, to simplify transition, the IFRIC also concluded that it should require retrospective application only from the beginning of the earliest comparative period presented because application to earlier periods would result only in a reclassification of amounts within equity.

Summary of main changes from the draft Interpretation

BC34 The main changes from the IFRIC's proposals in D25 are as follows:

(a) Paragraph 3 was added because the IFRIC identified specific transactions that are outside of the scope of the Interpretation.

(b) Paragraph 6 was modified to state that measurement should be based on the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

(c) Paragraph 7 was added to reflect the modification to paragraph 6. It also clarifies the intention of the IFRIC that in measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 49 of IAS 39 is not applied.

(d) Paragraph 8 was added, and paragraph 10 was modified, to clarify how the Interpretation should be applied when only part of the financial liability is extinguished by the issue of equity instruments.

(e) Paragraph 9 was modified to state when the equity instruments issued should be initially measured.

HK(SIC)-Int 31
Revised ~~September 2010~~May 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 31

Revenue — Barter Transactions Involving Advertising Services

CPA
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Hong Kong(SIC) Interpretation 31
Revenue - Barter Transactions Involving Advertising Services

HK(SIC) Interpretation 31 *Revenue - Barter Transactions Involving Advertising Services* (HK(SIC)-Int 31) is set out in paragraph 5. HK(SIC)-Int 31 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards.*

References

- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 18 *Revenue*

Issue

1 An entity (Seller) may enter into a barter transaction to provide advertising services in exchange for receiving advertising services from its customer (Customer). Advertisements may be displayed on the Internet or poster sites, broadcast on the television or radio, published in magazines or journals, or presented in another medium.

2 In some cases, no cash or other consideration is exchanged between the entities. In some other cases, equal or approximately equal amounts of cash or other consideration are also exchanged.

3 A Seller that provides advertising services in the course of its ordinary activities recognises revenue under HKAS 18 from a barter transaction involving advertising when, amongst other criteria, the services exchanged are dissimilar (HKAS 18.12) and the amount of revenue can be measured reliably (HKAS 18.20(a)). This Interpretation only applies to an exchange of dissimilar advertising services. An exchange of similar advertising services is not a transaction that generates revenue under HKAS 18.

4 The issue is under what circumstances can a Seller reliably measure revenue at the fair value of advertising services received or provided in a barter transaction.

Conclusion

5 Revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a Seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction, by reference only to non-barter transactions that:

(a) involve advertising similar to the advertising in the barter transaction;

(b) occur frequently;

(c) represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction;

(d) involve cash and/or another form of consideration (eg, marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and

(e) do not involve the same counterparty as in the barter transaction.

Basis for Conclusions

HK(SIC)-Int 31 is based on SIC Interpretation 31 *Revenue – Barter Transactions Involving Advertising Services*. In approving HK(SIC)-Int 31, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 31. Accordingly, there are no significant differences between HK(SIC)-Int 31 and SIC Interpretation 31. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 31 referred to below generally correspond with those in HK(SIC)-Int 31.

6 IAS 18.9 requires revenue to be measured at the fair value of the consideration received or receivable. When the fair value of the services received cannot be measured reliably, the revenue is measured at the fair value of the services provided, adjusted by the amount of any cash or cash equivalents transferred. IAS 18.26 states that when the outcome of a transaction involving the rendering of services cannot be estimated reliably (eg, the amount of revenue cannot be measured reliably), revenue should be recognised only to the extent of the expenses recognised that are recoverable. As explained in IAS 18.27, this means that revenue is recognised only to the extent of costs incurred that are expected to be recoverable and, as the outcome of the transactions cannot be estimated reliably, no profit is recognised.

7 Paragraph 31 of the *Framework*[1] states that information has the quality of reliability when it is free from material error and bias and is representationally faithful. Measuring revenue at the fair value of advertising services received from the Customer in a barter transaction is impracticable, because reliable information not available to the Seller is required to support the measurement. Consequently, revenue from a barter transaction involving advertising services is measured at the fair value of the advertising services provided by the Seller to the Customer.

8 IAS 18.7 defines fair value as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction[2]. A published price of a service does not constitute reliable evidence of its fair value, unless the price is supported by transactions with knowledgeable and willing parties in an arm's length transaction. For transactions to provide a relevant and reliable basis for support, the services involved are similar, there are many transactions, valuable consideration that can be reliably measured is exchanged, and independent third parties are involved. Consequently, the fair value of advertising services provided in a barter transaction is reliably measurable only when it is supportable by reference to non-barter transactions that have these characteristics.

9 However, a swap of cheques, for example, for equal or substantially equal amounts between the same entities that provide and receive advertising services does not provide reliable evidence of fair value. An exchange of advertising services that also includes only partial cash payment provides reliable evidence of the fair value of the transaction to the extent of the cash component (except when partial cash payments of equal or substantially equal amounts are swapped), but does not provide reliable evidence of the fair value of the entire transaction.

10 Reliable measurement of the fair value of a service also depends on a number of other factors, including the industry, the number of market participants, the nature of the services, and the number of market transactions. In the case of barter transactions involving advertising, the fair value of advertising services is reliably measurable when independent non-barter transactions involving similar advertising provide reliable evidence to substantiate the fair value of the barter exchange.

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1 The reference to the *Framework* is to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. Paragraph 31 was superseded by Chapter 3 of the *Conceptual Framework*.

2 IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

Date of issue

December 2004

Effective date

This Interpretation becomes effective for annual accounting periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies shall be accounted for in accordance with HKAS 8.

This Interpretation supersedes Interpretation 19 *Revenue - Barter Transactions Involving Advertising Service* (issued in July 2002).

HK(SIC)-Int 32
Revised ~~September 2010~~May 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 32

Intangible Assets — Web Site Costs

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

Hong Kong (SIC) Interpretation 32
Intangible Assets - Web Site Costs

HK(SIC) Interpretation 32 *Intangible Assets -Web Site Costs* (HK(SIC)-Int 32) is set out in paragraphs 7-10. HK(SIC)-Int 32 is accompanied by a Basis for Conclusions and appendix illustrating the application of the Interpretation. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards.*

References

- HKAS 1 *Presentation of Financial Statements* (as revised in 2007)
- HKAS 2 *Inventories*
- HKAS 11 *Construction Contracts*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 17 *Lease*
- HKAS 36 *Impairment of Assets*
- HKAS 38 *Intangible Assets*
- HKFRS 3 *Business Combinations*

Issue

1 An entity may incur internal expenditure on the development and operation of its own web site for internal or external access. A web site designed for external access may be used for various purposes such as to promote and advertise an entity's own products and services, provide electronic services, and sell products and services. A web site designed for internal access may be used to store company policies and customer details, and search relevant information.

2 The stages of a web site's development can be described as follows:

(a) Planning - includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences.

(b) Application and Infrastructure Development - includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing.

(c) Graphical Design Development - includes designing the appearance of web pages.

(d) Content Development - includes creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.

3 Once development of a web site has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design and content of the web site.

4 When accounting for internal expenditure on the development and operation of an entity's own web site for internal or external access, the issues are:

(a) whether the web site is an internally generated intangible asset that is subject to the requirements of HKAS 38; and

(b) the appropriate accounting treatment of such expenditure.

5 This Interpretation does not apply to expenditure on purchasing, developing, and operating hardware (eg web servers, staging servers, production servers and Internet connections) of a web site. Such expenditure is accounted for under HKAS 16 *Property, Plant and Equipment*. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's web site, the expenditure is recognised as an expense under HKAS 1.88 and the *Framework*[1] when the services are received.

6 HKAS 38 does not apply to intangible assets held by an entity for sale in the ordinary course of business (see HKAS 2 and HKAS 11) or leases that fall within the scope of HKAS 17. Accordingly, this Interpretation does not apply to expenditure on the development or operation of a web site (or web site software) for sale to another entity. When a web site is leased under an operating lease, the lessor applies this Interpretation. When a web site is leased under a finance lease, the lessee applies this Interpretation after initial recognition of the leased asset.

Conclusions

7 An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of HKAS 38.

8 A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in HKAS 38.21 for recognition and initial measurement, an entity can satisfy the requirements in HKAS 38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with HKAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when incurred.

9 Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with HKAS 38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development shall be evaluated to determine the appropriate accounting treatment (additional guidance is provided in the Appendix to this Interpretation). For example:

(a) the Planning stage is similar in nature to the research phase in HKAS 38.54-.56. Expenditure incurred in this stage shall be recognised as an expense when it is incurred.

[1] In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

(b) the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own products and services, are similar in nature to the development phase in HKAS 38.57-.64. Expenditure incurred in these stages shall be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this Interpretation when the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own products and services) specifically for a web site, or expenditure to enable use of the content (eg a fee for acquiring a licence to reproduce) on the web site, shall be included in the cost of development when this condition is met. However, in accordance with HKAS 38.71, expenditure on an intangible item that was initially recognised as an expense in previous financial statements shall not be recognised as part of the cost of an intangible asset at a later date (eg if the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site).

(c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products), shall be recognised as an expense when incurred in accordance with HKAS 38.69(c). For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure shall be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.

(d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage shall be recognised as an expense when it is incurred unless it meets the recognition criteria in HKAS 38.18.

10 A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation shall be measured after initial recognition by applying the requirements of HKAS 38.72-.87. The best estimate of a web site's useful life should be short.

Basis for Conclusions

HK(SIC)-Int 32 is based on SIC Interpretation 32 *Intangible Assets -Web Site Costs*. In approving HK(SIC)-Int 32, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 32. Accordingly, there are no significant differences between HK(SIC)-Int 32 and SIC Interpretation 32. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 32 referred to below generally correspond with those in HK(SIC)-Int 32.

11 An intangible asset is defined in IAS 38.8 as an identifiable non-monetary asset without physical substance. IAS 38.9 provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset.

12 IAS 38.68 requires expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in IAS 38.18-.67. IAS 38.69 requires expenditure on start-up activities to be recognised as an expense when incurred. An entity developing its own web site for internal or external access is not undertaking a start-up activity to the extent that an internally generated intangible asset is created. The requirements and guidance in IAS 38.52-.67, in addition to the general requirements described in IAS 38.21 for recognition and initial measurement of an intangible asset, apply to expenditure incurred on the development of an entity's own web site. As described in IAS 38.65-.67, the cost of a web site recognised as an internally generated intangible asset comprises all expenditure that can be directly attributed and is necessary to creating, producing and preparing the asset for it to be capable of operating in the manner intended by management.

13 IAS 38.54 requires expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in IAS 38.56 are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditure incurred in the Planning stage of a web site's development is recognised as an expense when incurred.

14 IAS 38.57 requires an intangible asset arising from the development phase of an internal project to be recognised only if an entity can demonstrate fulfilment of the six criteria specified. One of the criteria is to demonstrate how a web site will generate probable future economic benefits (IAS 38.57(d)). IAS 38.60 indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in IAS 36 *Impairment of Assets*, which considers the present value of estimated future cash flows from continuing use of the web site. Future economic benefits flowing from an intangible asset, as stated in IAS 38.17, may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. Therefore, future economic benefits from a web site may be assessed when the web site is capable of generating revenues. A web site developed solely or primarily for advertising and promoting an entity's own products and services is not recognised as an intangible asset, because the entity cannot demonstrate the future economic benefits that will flow. Consequently, all expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred.

15 Under IAS 38.21, an intangible asset is recognised if, and only if, it meets specified criteria. IAS 38.65 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the specified recognition criteria. When an entity acquires or creates content for purposes other than to advertise and promote an entity's own products and services, it may be possible to identify an intangible asset (eg a licence or a copyright) separate from a web site. However, a separate asset is not recognised when expenditure is directly attributed, to creating, producing, and preparing the web site for it to be capable of operating in the manner intended by management—the expenditure is included in the cost of developing the web site.

16 IAS 38.69(c) requires expenditure on advertising and promotional activities to be recognised as an expense when incurred. Expenditure incurred on developing content that advertises and promotes an entity's own products and services (eg digital photographs of products) is an advertising and promotional activity, and consequently recognised as an expense when incurred.

17 Once development of a web site is complete, an entity begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an entity's own web site is recognised as an expense when incurred unless it meets the recognition criteria in IAS 38.18. IAS 38.20 explains that most subsequent expenditures are likely to maintain the future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria set out in IAS 38. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure — expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset — be recognised in the carrying amount of an asset[*].

18 An intangible asset is measured after initial recognition by applying the requirements of IAS 38.72-.87. The revaluation model in IAS 38.75 is applied only when the fair value of an intangible asset can be determined by reference to an active market.[†] However, as an active market is unlikely to exist for web sites, the cost model applies. Additionally, as indicated in IAS 38.92, many intangible assets are susceptible to technological obsolescence, and given the history of rapid changes in technology, the useful life of web sites will be short.

Date of Issue

December 2004

Effective Date

This Interpretation becomes effective for annual accounting periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies shall be accounted for in accordance with HKAS 8.

HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 5. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

This Interpretation supersedes Interpretation 19 *Intangible Asset – Website Costs* (issued in October 2002).

[*] The new text was added by IFRS 3 *Business Combinations* in 2004.

[†] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 defines an active market.

Appendix to SIC-32

This appendix accompanies, but is not part of, SIC-32. The purpose of the appendix is to illustrate examples of expenditure that occur during each of the stages described in paragraphs 2 and 3 of SIC-32 and illustrate application of SIC-32 to assist in clarifying its meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

Example application of SIC-32

Stage / nature of expenditure	Accounting treatment
Planning	
● undertaking feasibility studies ● defining hardware and software specifications ● evaluating alternative products and suppliers ● selecting preferences	Recognise as an expense when incurred in accordance with IAS 38.54
Application and infrastructure development	
● purchasing or developing hardware	Apply the requirements of IAS 16
● obtaining a domain name ● developing operating software (eg operating system and server software) ● developing code for the application ● installing developed applications on the web server ● stress testing	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57[(a)]
Graphical design development	
● designing the appearance (eg layout and colour) of web pages	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57[(a)]
Content development	
● creating, purchasing, preparing (eg creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an entity, products or services offered for sale, and topics that subscribers access	Recognise as an expense when incurred in accordance with IAS 38.69(c) to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products). Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57[(a)] ***continued…***

…continued **Stage / nature of expenditure**	**Accounting treatment**
Operating ● updating graphics and revising content ● adding new functions, features and content ● registering the web site with search engines ● backing up data ● reviewing security access ● analysing usage of the web site	Assess whether it meets the definition of an intangible asset and the recognition criteria set out in IAS 38.18, in which case the expenditure is recognised in the carrying amount of the web site asset
Other ● selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management ● clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (eg false-start testing) ● training employees to operate the web site	Recognise as an expense when incurred in accordance with IAS 38.65-.70
[(a)] All expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred in accordance with IAS 38.68.	