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

MEMBERS' HANDBOOK

Update No. 259

(Issued 20 April 2021)

This Update relates to the publication of amendments to HKAS 1 *Presentation of Financial Statements* and HKFRS Practice Statement 2 *Making Materiality Judgements* (Disclosure of Accounting Policies) and amendments to HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (Definition of Accounting Estimates).

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard existing pages i and iv, and replace with revised pages i and iv.	Revised contents pages
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 1 *Presentation of Financial Statements*	Replace the cover page and pages 2, 4, 43-49, 58 and 119-120 with revised cover page and revised pages 2, 4, 43-49, 58 and 119-120. Insert pages 91E-91K after page 91D.	Notes 1 & 3
HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*	Replace the cover page and pages 2, 4 and 22 with revised cover page and revised pages 2, 4 and 22. Insert pages 22A-22B after page 22, pages 29B-29F after page 29A, pages 35A-35D after page 35.	Notes 2 & 3
HKFRS PRACTICE STATEMENT		
HKFRS Practice Statement 2 *Making Materiality Judgements*	Replace the cover page and page 4 with revised cover page and revised page 4. Insert pages 34A-34H after page 34, pages 44-45 after page 43.	Notes 1 & 3

Note:

1. The amendments to Disclosure of Accounting Policies were issued following feedback that more guidance was needed to help companies decide what accounting policy information should be disclosed. The amendments to HKAS 1 require companies to disclose their material accounting policy information rather than their significant accounting policies. The amendments to HKFRS Practice Statement 2 provide guidance on how to apply the concept of materiality to accounting policy disclosures.

2. The amendments to HKAS 8 clarify how companies should distinguish changes in accounting policies from changes in accounting estimates. That distinction is important because changes in accounting estimates are applied prospectively only to future transactions and other future events, but changes in accounting policies are generally also applied retrospectively to past transactions and other past events.

3. The amendments to HKAS 1 and HKAS 8 will be effective for annual reporting periods beginning on or after 1 January 2023, with early application permitted.

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

MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to April 2021)

HKAS 1 (Revised)
Revised ~~August 2020~~April 2021

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

Hong Kong Accounting Standard 1 *Presentation of Financial Statements* (HKAS 1) is set out in paragraphs 1–140 and Appendices A & ~~C~~D. 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 August 2020. It supersedes HKAS 1, issued in 2004, as amended in 2005.

Appendix D

Amendments to Disclosure of Accounting Policies

The following sets out amendments required for this Standard resulting from amendments to HKAS 1 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.

Paragraphs 7, 10, 114, 117 and 122 are amended. Paragraphs 117A–117E and 139V are added. Paragraphs 118, 119 and 121 are deleted. New text is underlined and deleted text is struck through.

Definitions

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

<u>*Accounting policies* are defined in paragraph 5 of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and the term is used in this Standard with the same meaning.</u>

…

Financial statements

...

Complete set of financial statements

10 A complete set of financial statements comprises:

…

(e) notes, comprising <u>material</u> ~~significant~~ accounting <u>policy information</u> ~~policies~~ and other explanatory information;

…

Structure and content

...

Notes

Structure

...

114 Examples of systematic ordering or grouping of the notes include:

…

(c) following the order of the line items in the statement(s) of profit or loss and other comprehensive income and the statement of financial position, such as:

…

(ii) material ~~significant~~ accounting policy information ~~policies applied~~ (see paragraph 117);

…

Disclosure of accounting policy information ~~policies~~

117 An entity shall disclose material ~~its significant~~ accounting policy information (see paragraph 7). Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements. ~~policies comprising:~~

~~(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.~~

117A Accounting policy information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may nevertheless be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial. However, not all accounting policy information relating to material transactions, other events or conditions is itself material.

117B Accounting policy information is expected to be material if users of an entity's financial statements would need it to understand other material information in the financial statements. For example, an entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, other events or conditions and:

(a) the entity changed its accounting policy during the reporting period and this change resulted in a material change to the information in the financial statements;

(b) the entity chose the accounting policy from one or more options permitted by HKFRSs—such a situation could arise if the entity chose to measure investment property at historical cost rather than fair value;

(c) the accounting policy was developed in accordance with HKAS 8 in the absence of an HKFRS that specifically applies;

(d) the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions in accordance with paragraphs 122 and 125; or

(e) the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events or conditions—such a situation could arise if an entity applies more than one HKFRS to a class of material transactions.

117C Accounting policy information that focuses on how an entity has applied the requirements of the HKFRSs to its own circumstances provides entity-specific information that is more useful to users of financial statements than standardised information, or information that only duplicates or summarises the requirements of the HKFRSs.

117D If an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information.

117E An entity's conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other HKFRSs.

118 [Deleted]~~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 [Deleted]~~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. 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. 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 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 [Deleted]

121 [Deleted]~~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, along with material ~~its significant~~ accounting policy information ~~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.

...

Transition and effective date

...

139V *Disclosure of Accounting Policies*, issued in April 2021, amended paragraphs 7, 10, 114, 117 and 122, added paragraphs 117A–117E and deleted paragraphs 118, 119 and 121. It also amended HKFRS Practice Statement 2 *Making Materiality Judgements*. An entity shall apply the amendments to HKAS 1 for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Consequential amendments to other standards

The following amendments are a consequence of the amendments to Disclosure of Accounting Policies in HKAS 1. These amendments are applied at the same time an entity applies the amendments to Disclosure of Accounting Policies in HKAS 1.

Amendments to HKFRS 7 *Financial Instruments: Disclosures*

Paragraphs 21 and B5 are amended. Paragraph 44II is added. New text is underlined and deleted text is struck through.

Significance of financial instruments for financial position and performance

...

Other disclosures

Accounting policies

21 In accordance with paragraph 117 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007), an entity discloses material ~~its significant~~ accounting policy information ~~policies comprising 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~~. Information about the measurement basis (or bases) for financial instruments used in preparing the financial statements is expected to be material accounting policy information.

...

Effective date and transition

...

44II *Disclosure of Accounting Policies*, which amends HKAS 1 and HKFRS Practice Statement 2 *Making Materiality Judgements*, and was issued in April 2021, amended paragraphs 21 and B5. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

...

Appendix B
Application guidance

...

Classes of financial instruments and level of disclosure (paragraph 6)

...

Other disclosure—accounting policies (paragraph 21)

B5 Paragraph 21 requires disclosure of material accounting policy information, which is expected to include information about the measurement basis (or bases) for financial instruments 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:

…

Paragraph 122 of HKAS 1 (as revised in 2007) also requires entities to disclose, along with material ~~its significant~~ accounting policy information ~~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.

Amendments to HKAS 26 *Accounting and Reporting by Retirement Benefit Plans*

Paragraph 34 is amended and paragraph 38 is added. New text is underlined and deleted text is struck through.

All plans

Disclosure

34 **The financial statements of a retirement benefit plan, whether defined benefit or defined contribution, shall also contain the following information:**

…

(b) **material ~~a summary of significant~~ accounting policy information ~~policies~~; and**

…

Effective date

...

38 *Disclosure of Accounting Policies*, which amends HKAS 1 *Presentation of Financial Statements* and HKFRS Practice Statement 2 *Making Materiality Judgements*, and was issued in April 2021, amended paragraph 34. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

Amendments to HKAS 34 *Interim Financial Reporting*

Paragraph 5 is amended and paragraph 60 is added. New text is underlined and deleted text is struck through.

Content of an interim financial report

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

…

(e) notes, material ~~comprising significant~~ accounting policy information ~~policies~~ and other explanatory information;

…

Effective date

...

60 *Disclosure of Accounting Policies*, which amends HKAS 1 and HKFRS Practice Statement 2 *Making Materiality Judgements*, and was issued in April 2021, amended paragraph 5. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

Appendix

Amendments to the Basis for Conclusions on Disclosure of Accounting Policies

This appendix contains amendments to the Basis for Conclusions on IAS 1 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.

A footnote is added to the words 'significant accounting policies' in paragraphs BC76C and BC76F. New text is underlined.

* *Disclosure of Accounting Policies*, issued in February 2021, amended paragraphs 117–122 of IAS 1, which now refer to 'material accounting policy information'.

The heading above paragraph BC76F is amended. Paragraphs BC76H–BC76AB and their related headings are added. For ease of reading, new text is not underlined.

Notes

...

Disclosure of accounting policy information ~~policies~~ (paragraphs 117–117E~~121~~)

BC76F …

...

Disclosure of accounting policies (issued February 2021)

Background

BC76H In March 2017 the Board published the Discussion Paper *Disclosure Initiative—Principles of Disclosure* (Discussion Paper) to help it identify and address issues related to the disclosure of information in financial statements prepared by an entity applying IFRS Standards. One issue related to the disclosure of information about accounting policies.

BC76I The Discussion Paper noted that paragraph 117 of IAS 1 required entities to disclose their significant accounting policies and that stakeholders, including primary users of financial statements, differ in their views about what constitutes a significant accounting policy.

BC76J Feedback on the Discussion Paper suggested that the Board develop requirements and guidance to help entities make more effective accounting policy disclosures. Feedback from stakeholders suggested that materiality be the basis of such requirements or guidance.

BC76K In August 2019 the Board published the Exposure Draft *Disclosure of Accounting Policies*, which proposed to amend IAS 1 and IFRS Practice Statement 2 *Making Materiality Judgements.*

Replacing 'significant' with 'material'

BC76L The Board found that, because 'significant' is not defined in IFRS Standards, entities can have difficulty assessing whether an accounting policy is 'significant'. The Board also noted that entities can have difficulty understanding the difference, if any, between 'significant' and 'material' accounting policies. The Board considered developing a definition of 'significant', but concluded that this approach could have unintended consequences for other uses of the term 'significant' in IFRS Standards.

BC76M Because 'material' is defined in IFRS Standards and is well understood by stakeholders, the Board decided to require entities to disclose their material accounting policy information instead of their significant accounting policies.

BC76N The Board observed that accounting policy information considered in isolation would rarely be assessed as material because it would be unlikely to influence the decisions of users of financial statements. However, accounting policy information may be considered material when that information is considered together with other information in a complete set of financial statements. In the Board's view, accounting policy information is expected to be material if its disclosure were needed for primary users to understand information provided about material transactions, other events or conditions in the financial statements.

Applying the definition of material to accounting policy disclosures

BC76O The Board received comments that:

(a) accounting policy disclosures are useful to users of financial statements when they:

  (i) relate to material transactions, other events or conditions; and

  (ii) provide insight into how an entity has exercised judgement in selecting and applying accounting policies; and

(b) users of financial statements find entity-specific information more useful than accounting policy disclosures that:

  (i) contain standardised information, sometimes called boilerplate information; and

  (ii) only duplicate or summarise the content of the recognition and measurement requirements of IFRS Standards.

BC76P To assist an entity in determining whether accounting policy information is material to its financial statements and to respond to the feedback described in paragraphs BC76J and BC76O, the Board added paragraphs to IAS 1 to:

(a) clarify that not all accounting policy information relating to material transactions, other events or conditions is material (see paragraph 117A). The Board concluded that this amendment would help an entity reduce immaterial accounting policy disclosures in its financial statements.

(b) provide examples of circumstances in which an entity would normally conclude that information about an accounting policy is material to its financial statements (see paragraph 117B). The examples listed in paragraph 117B are not exhaustive but the Board concluded that they would help an entity determine whether accounting policy information is material.

(c) explain that entity-specific accounting policy information is more useful to users of financial statements than accounting policy information that is standardised, or that duplicates or summarises the requirements of IFRS Standards (see paragraph 117C). The Board concluded that this amendment would help an entity focus on disclosing accounting policy information that users have identified as the most useful.

BC76Q The definition of material (see paragraph 7) states that 'materiality depends on the nature or magnitude of information, or both'. Consequently, in assessing whether accounting policy information is material, an entity is required to consider not just the size of the transactions, other events or conditions to which the accounting policy information relates, but also the nature of those transactions, other events or conditions. To clarify this point, the Board included in the amendments an explanation that accounting policy information can be judged material because of the nature of the related transactions, other events or conditions, even if the amounts to which that information relates are immaterial (see paragraph 117A).

BC76R Some respondents to the Exposure Draft said that sometimes accounting policy information that includes standardised information or that duplicates or summarises some of the requirements of IFRS Standards can provide users of financial statements with material information. In the Board's view, accounting policy information that includes standardised information or that duplicates or summarises some of the requirements of IFRS Standards is generally less useful to users than entity-specific accounting policy information. However, the Board agreed that such accounting policy information is expected to be material if it is needed to understand other material information in the financial statements. The Board concluded that when such information is material, it is required to be disclosed.

BC76S Such information could be material, for example, when an entity judges the accounting required for a material transaction, other event or condition to be so complex that a primary user would be unable to understand the related material transaction, other event or condition in the absence of that information (see paragraph 117B(e)). The Board acknowledged that because the complexity of accounting required for particular transactions, other events or conditions is ultimately a subjective question, an entity will need to judge whether the relevant accounting is complex. However, the Board concluded that the guidance in the amendments would be sufficient for an entity, auditors, regulators and others to make appropriate judgements about the materiality of such information.

BC76T An entity is permitted to disclose accounting policy information that is standardised, or that duplicates or summarises the requirements of IFRS Standards, even when that information is assessed as immaterial. However, if an entity discloses such information, it shall not obscure material accounting policy information (see paragraph 117D).

BC76U The Board deleted the discussion of 'measurement basis (or bases)' in paragraphs 117 and 118. The Board did so to better enable preparers to apply judgement and thereby disclose only material accounting policy information. In many cases, information about the measurement basis (or bases) used in preparing the financial statements is material. However, in some cases, the measurement basis (or bases) used for a particular asset or liability would not be material and, therefore, would not need to be disclosed. For example, information about a measurement basis might be immaterial if:

(a) an IFRS Standard required an entity to use a measurement basis—in which case an entity would not apply choice or judgement in complying with the Standard; and

(b) information about the measurement basis would not be needed for users to understand the related material transactions, other events or conditions.

BC76V The Board decided to emphasise that the amendments do not relieve an entity from meeting other disclosure requirements within IFRS Standards (see paragraph 117E). For example, if an entity applying the amendments decides that accounting policy information about intangible assets is immaterial to its financial statements, the entity would still need to disclose the information required by IAS 38 *Intangible Assets* that the entity had determined to be material.

References to accounting policies in other IFRS Standards and publications

BC76W Other IFRS Standards sometimes require an entity to disclose an accounting policy. For example, paragraph 73 of IAS 16 *Property, Plant and Equipment* requires an entity to disclose the measurement bases used for determining the gross carrying amount of property, plant and equipment. The Board considered whether any of these requirements should be changed because of the amendments to IAS 1. However, the Board noted that paragraph 31 states that disclosure requirements in IFRS Standards are subject to materiality judgements—a disclosure required by an IFRS Standard is required to be provided only if the information resulting from that disclosure is material. Consequently, the Board concluded that amendments to requirements relating to accounting policy disclosures in other IFRS Standards are unnecessary.

Effect analysis

BC76X The Board acknowledged that the amendments may have:

(a) an initial cost to preparers as they change from applying the concept of significance to applying the concept of materiality to accounting policy information; and

(b) ongoing costs to preparers, because the amendments require an entity to apply its own judgement to determine what accounting policy information is material and should, therefore, be disclosed in the financial statements.

BC76Y However, in the Board's view, the amendments will improve the relevance of the financial statements by helping an entity to:

(a) identify and disclose accounting policy information that is material to users of financial statements; and

(b) remove immaterial accounting policy information that may obscure material accounting policy information.

BC76Z The Board also expects that the amendments:

(a) are unlikely to be complex or costly to implement because they do not affect recognition and measurement, and will not require significant system changes to implement; and

(b) will reduce the cost of preparing and using financial statements by reducing the disclosure of immaterial accounting policy information.

BC76AA Consequently, the Board expects that the benefits of the amendments will outweigh the costs.

Transition and comparative information

BC76AB The amendments affect the disclosure of narrative and descriptive information. Paragraph 38 specifies that comparative information is only required for narrative and descriptive information if it is 'relevant to understanding the current period's financial statements'. In the Board's view, providing comparative accounting policy information would be unnecessary in most circumstances because if the accounting policy:

(a) is unchanged from the comparative periods, the disclosure of the current period's accounting policy is likely to provide users with all the accounting policy information that is relevant to an understanding of the current period's financial statements; or

(b) has changed from the comparative periods, the disclosures required by paragraphs 28–29 of IAS 8 are likely to provide any information about the comparative period's accounting policies that is relevant to an understanding of the current period's financial statements.

Consequential amendments to the Basis for Conclusions on Other Standards

The following amendments to the Basis for Conclusions are a consequence of the amendments to Disclosure of Accounting Policies in IAS 1.

Amendments to the Basis for Conclusions on IFRS 7

Paragraphs BC35ZA and BC35ZB and their related headings are added. New text is underlined.

Disclosures about the significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)

...

<u>Other Disclosures—Accounting Policies</u>

<u>Amendments to IAS 1 (see paragraphs BC76H–BC76AB of IAS 1)</u>

<u>BC35ZA</u> <u>In February 2021 the Board amended IAS 1 to require an entity to disclose its material accounting policy information rather than its significant accounting policies.</u>

<u>BC35ZB</u> <u>As part of the amendments to IAS 1, the Board deleted from paragraph 117 of that Standard the description of what an accounting policy comprises, including the reference to ‘measurement basis (or bases)’. The Board expects that, for financial instruments, information about the measurement basis (or bases) used for the recognition and measurement of financial instruments is likely to be material to an entity’s financial statements. Consequently, the Board decided to retain the reference in paragraph 21 to ‘measurement basis (or bases)’ in describing what accounting policy information relating to financial instruments could be assessed as material to an entity’s financial statements.</u>

Dissenting opinion

Dissent of Ms Françoise Flores from *Disclosure of Accounting Policies*

DO1 Ms Flores voted against the publication of *Disclosure of Accounting Policies*, which amends IAS 1 and IFRS Practice Statement 2. The reasons for her dissent are set out below.

DO2 Ms Flores agrees with those amendments to IAS 1 and IFRS Practice Statement 2 which aim to provide primary users of financial statements with all and only relevant accounting policy information. She also supports the Board's past and current efforts to clarify how the concept of materiality should be applied more generally. She agrees with all the amendments except paragraph 117B(e) of IAS 1 and paragraph 88F of IFRS Practice Statement 2.

DO3 In particular, Ms Flores disagrees with paragraph 117B(e) of IAS 1, which implies that accounting policy information that includes information that is standardised or duplicates the requirements of IFRS Standards could be material when the underlying accounting is complex; and that, therefore, such information is required to be included in the financial statements. Ms Flores believes that the notion of complexity is highly subjective and, therefore, does not constitute a robust basis for a requirement. Introducing such a subjective assessment could, in her view, undermine the overall aim of the amendments, which is to contribute to a better application of the concept of materiality to accounting policy disclosures and thereby help an entity reduce the disclosure of immaterial accounting policy information. Facing such subjective judgements, an entity may opt for 'being on the safe side', providing more information than is required. In her view, paragraph 117B(e) of IAS 1 is an unsatisfactory response to feedback from users of financial statements who said they find entity-specific accounting policy information to be more useful than information that is standardised or that duplicates or summarises the requirements of IFRS Standards.

DO4 A minority of respondents were concerned that the Board's proposals could be read as prohibiting the publication of any accounting policy information that is standardised, or that duplicates or summarises the requirements of IFRS Standards. Ms Flores believes that the appropriate response would have been to explain that such accounting policy information may, in some circumstances, be useful in providing context for entity-specific information. Such an approach would enhance the readability of entity-specific accounting policy information.

DO5 Furthermore, Ms Flores notes that paragraph 2.36 of the *Conceptual Framework of Financial Reporting*, paragraph 7 of IAS 1 and the guidance included in paragraphs 13–23 of IFRS Practice Statement 2 state that users of financial statements are expected to have a reasonable knowledge of business and economic activities, but may need to seek the aid of an adviser to cope with perceived complexity. In her view, investors are responsible for ensuring that their economic decisions are derived from a proper and knowledgeable understanding of an entity's financial statements, which includes understanding the requirements of IFRS Standards. IFRS Standards should be regarded as public knowledge in a financial reporting environment. No mere recitation of the words from the IFRS Standards can meet the definition of material without stretching that definition endlessly. In Ms Flores' view, improving users' understanding of the requirements in IFRS Standards should be achieved through education by the IFRS Foundation. Such an objective should not be achieved by amending the requirements of IFRS Standards.

Appendix
Amendment to Guidance on implementing IAS 1 Disclosure of Accounting Policies

The following sets out amendment required for this Implementation Guidance resulting from amendments to IAS 1 that are not yet effective. Once effective, the amendment sets out below will be incorporated into the text of this Guidance and this appendix will be deleted.

Paragraph IG6 is amended. New text is underlined and deleted text is struck through.

Illustrative financial statement structure

...

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, disclosures about material ~~significant~~ accounting policy information ~~policies~~ and other explanatory information.

Consequential amendment to Implementation Guidance on other Standards

The following amendment to Implementation Guidance is a consequence of the amendments to Disclosure of Accounting Policies in IAS 1.

Amendment to Guidance on implementing IFRS 8 *Operating Segments*

Paragraph IG2 is amended. New text is underlined and deleted text is struck through.

Descriptive information about an entity's reportable segments

IG2 The following illustrates the disclosure of descriptive information about an entity's reportable segments (the paragraph references are to the relevant requirements in the IFRS).

…

Measurement of operating segment profit or loss, assets and liabilities (paragraph 27)

The accounting policy information about ~~policies of the~~ operating segments is ~~are~~ the same as that ~~those~~ described as part of the material ~~in the significant~~ accounting policy information, ~~policies~~ except that pension expense for each operating segment is recognised and measured on the basis of cash payments to the pension plan. Diversified Company evaluates performance on the basis of profit or loss from operations before tax expense not including non-recurring gains and losses and foreign exchange gains and losses.

…

HKAS 8

Revised ~~August 2020~~April 2021

Effective for annual periods beginning on or after 1 January 2005

Hong Kong Accounting Standard 8

Accounting Policies, Changes in Accounting Estimates and Errors

CPA

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

APPENDICES:

A Comparison with International Accounting Standards

B Amendments to other pronouncements

C Amendments to Definition of Accounting Estimates

BASIS FOR CONCLUSIONS

APPENDIX:

Amendments to the Basis for Conclusions on Definition of Accounting Estimates

IMPLEMENTATION GUIDANCE

APPENDIX:

Amendments to the Guidance on implementing IAS 8 Definition of Accounting Estimates

TABLE OF CONCORDANCE

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

Appendix C

Amendments to Definition of Accounting Estimates

The following sets out amendments required for this Standard resulting from amendments to HKAS 8 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.

Paragraphs 5, 32, 34, 38 and 48 and the heading above paragraph 32 are amended. Paragraphs 32A–32B, 34A and 54I and the headings above paragraphs 34 and 36 are added. The heading above paragraph 39 is amended to be a sub-heading of the heading added above paragraph 34. Deleted text is struck through and new text is underlined.

Definitions

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

…

***Accounting estimates* are monetary amounts in financial statements that are subject to measurement uncertainty.**

~~**A *change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.**~~

…

Accounting ~~Changes in accounting~~ estimates

32 An accounting policy may require items in financial statements to be measured in a way that involves measurement uncertainty—that is, the accounting policy may require such items to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, an entity develops an accounting estimate to achieve the objective set out by the accounting policy. ~~As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated.~~ Developing accounting estimates involves the use of judgements or assumptions ~~Estimation involves judgements~~ based on the latest available, reliable information. Examples of accounting estimates include ~~For example, estimates may be required of~~:

(a) a loss allowance for expected credit losses, applying HKFRS 9 *Financial Instruments*~~bad debts~~;

(b) the net realisable value of an item of inventory, applying HKAS 2 *Inventories*~~inventory obsolescence~~;

(c) the fair value of an asset or liability, applying HKFRS 13 *Fair Value Measurement* ~~financial assets or financial liabilities~~;

(d) the depreciation expense for an item of property, plant and equipment, applying HKAS 16~~the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets~~; and

(e) a provision for warranty obligations, applying HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

32A An entity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques (for example, techniques used to measure a loss allowance for expected credit losses applying HKFRS 9) and valuation techniques (for example, techniques used to measure the fair value of an asset or liability applying HKFRS 13).

32B The term 'estimate' in HKFRSs sometimes refers to an estimate that is not an accounting estimate as defined in this Standard. For example, it sometimes refers to an input used in developing accounting estimates.

…

Changes in accounting estimates

34 An entity may need to change an accounting estimate ~~may need revision~~ if changes occur in the circumstances on which the accounting estimate was based or as a result of new information, new developments or more experience. By its nature, a change in an accounting ~~the revision of an~~ estimate does not relate to prior periods and is not the correction of an error.

34A The effects on an accounting estimate of a change in an input or a change in a measurement technique are changes in accounting estimates unless they result from the correction of prior period errors.

…

Applying changes in accounting estimates

…

38 Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of that ~~the~~ change~~ in estimate~~. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in a loss allowance for expected credit losses ~~the estimate of the amount of bad debts~~ affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

~~Disclosure~~

Disclosure

…

Errors

…

48 Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need changing ~~revision~~ as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.

…

Effective date and transition

…

54I *Definition of Accounting Estimates*, issued in April 2021, amended paragraphs 5, 32, 34, 38 and 48 and added paragraphs 32A, 32B and 34A. An entity shall apply these amendments for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. An entity shall apply the amendments to changes in accounting estimates and changes in accounting policies that occur on or after the beginning of the first annual reporting period in which it applies the amendments.

Appendix

Amendments to the Basis for Conclusions on Definition of Accounting Estimates

This appendix contains amendments to the Basis for Conclusions on IAS 8 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.

Paragraph BC1 is amended with new text underlined. Paragraphs BC42–BC59 and related headings are added. For ease of reading, paragraphs BC42–BC59 and the related headings have not been underlined.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* in 2003 and on subsequent amendments. Individual Board members gave greater weight to some factors than to others.

…

Definition of Accounting Estimates (2021 amendments)

Background

BC42 The IFRS Interpretations Committee informed the Board of difficulties entities faced in distinguishing changes in accounting policies from changes in accounting estimates. The Board understood that such difficulties arose because the previous definition of a change in accounting estimate in IAS 8 was not sufficiently clear.

BC43 In February 2021, the Board issued *Definition of Accounting Estimates*, which amended IAS 8. The amendments introduced the definition of accounting estimates in paragraph 5 and included other amendments to IAS 8 to help entities distinguish changes in accounting estimates from changes in accounting policies.

Definition of accounting estimates

BC44 Before the 2021 amendments, IAS 8 included definitions of 'accounting policies' and 'change in accounting estimate'. The combination of a definition of one item (accounting policies) with a definition of changes in another item (change in accounting estimate) obscured the distinction between accounting policies and accounting estimates. To make that distinction clearer, the Board replaced the definition of a change in accounting estimate with a definition of accounting estimates. The main matters the Board considered in developing the definition and related requirements included:

(a) *the relationship between accounting policies and accounting estimates*—the amendments clarify the relationship between accounting policies and accounting estimates by specifying that an entity develops an accounting estimate to achieve the objective set out by an accounting policy. The Board's view was that this clarification would help entities distinguish changes in accounting estimates from changes in accounting policies.

(b) *judgements and assumptions*—when it exposed a draft of the 2021 amendments for comment, the Board proposed defining accounting estimates as judgements and assumptions used in applying accounting policies when an item cannot be measured with precision. However, the Board agreed with feedback suggesting it would be more helpful to specify that accounting estimates are the output of measurement techniques that require an entity to use judgements or assumptions and that the judgements or assumptions are not accounting estimates themselves. This approach also avoids confusion about whether other judgements and assumptions an entity makes in preparing its financial statements are accounting estimates.

(c) *measurement uncertainty*—the Board introduced the term 'measurement uncertainty' in the definition. The Board concluded that using this term would make the definition clearer and be consistent with the 2018 *Conceptual Framework.*[1]

(d) *monetary amounts*—the definition refers to monetary amounts for consistency with the definition of measurement uncertainty.[2] The Board considered whether the definition should also refer to non-monetary amounts (for example, the useful life of depreciable assets). However, the Board observed that entities use non-monetary amounts as inputs to estimate monetary amounts in the financial statements—for example, an entity uses the useful life of an asset (a non-monetary amount) as an input in estimating the depreciation expense for that asset (a monetary amount). Because the effects of changes in inputs used to develop an accounting estimate are changes in accounting estimates (see paragraph BC46), the Board concluded that it was unnecessary to also include non-monetary amounts in the definition of accounting estimates.

(e) *scope*—the Board considered whether the definition should also capture estimates used in applying accounting policies for matters other than measuring items in financial statements (for example, estimates used in determining whether to recognise an item in the financial statements). The previous definition of a change in accounting estimate referred to 'adjustments to the carrying amount' of an asset or liability and, therefore, captured only changes in the measurement of items recognised in financial statements. The Board concluded that the amendments should not change the scope of IAS 8 and, accordingly, limited the definition to capture only monetary amounts that are subject to measurement uncertainty.

1 Measurement uncertainty is defined in the Appendix to the 2018 *Conceptual Framework* as the 'uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated'.

2 The term 'monetary amount' does not have the same meaning as the term 'monetary item' as defined in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Changes in accounting estimates

BC45 The previous definition of a change in accounting estimate specified that changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors. The Board concluded that it would be helpful to retain this aspect of the previous definition and specify that a change in accounting estimate may result from new information or new developments and is not the correction of an error.

BC46 The Board also concluded that, if accounting estimates are outputs of measurement techniques, it follows that changes in the inputs used, or in the measurement techniques applied to determine those outputs, result in a change in the related accounting estimate and are not the result of a change in accounting policy.

BC47 In the light of its observations summarised in paragraphs BC45–BC46, the Board specified that:

(a) a change in accounting estimate may result from new information or new developments and is not the correction of an error; and

(b) the effects of a change in an input or in a measurement technique used to develop an accounting estimate are changes in accounting estimates unless they result from the correction of prior period errors.

BC48 Feedback on the draft amendments expressed a concern that measurement techniques might meet the definition of accounting policies—for example, a valuation technique is a measurement technique but could also be seen as a practice and, therefore, meet the definition of an accounting policy. Accordingly, there is a risk that the effects of a change in a measurement technique could be seen as both a change in accounting estimate and a change in accounting policy. To avoid this risk, the Board specified in paragraph 34A that the effects of a change in measurement technique are changes in accounting estimates unless they result from the correction of prior period errors.

BC49 The Board also specified that measurement techniques an entity uses to develop accounting estimates include estimation techniques and valuation techniques. Specifying this avoids ambiguity about whether the effect of a change in an estimation technique or a valuation technique is a change in accounting estimate. The terms ‘estimation techniques’ and ‘valuation techniques’ appear in IFRS Standards—for example, IFRS 7 *Financial Instruments: Disclosures* uses the term ‘estimation techniques’ and IFRS 13 *Fair Value Measurement* uses the term ‘valuation techniques’.

BC50 The Board observed that the term ‘estimate’ in IFRS Standards sometimes refers not only to accounting estimates, but also to other estimates. For example, it sometimes refers to inputs used in developing accounting estimates. As discussed in paragraph BC47(b), the Board specified that the effects on an accounting estimate of a change in an input are changes in accounting estimates. Therefore, the Board concluded it was unnecessary to also amend references to the term ‘estimate’ when that term refers to an input used in developing accounting estimates.

Definition of 'accounting policies'

Clarifying the definition

BC51 When it exposed the draft amendments for comment, the Board also proposed to clarify the definition of accounting policies by removing the terms 'conventions' and 'rules', and referring to 'measurement bases' instead of 'bases'. The Board expected that those changes would not change the scope of the definition. However, feedback suggested those proposed changes:

(a) might not improve the definition, because the remaining terms in the definition would remain undefined and could be open to diverse interpretations; and

(b) might unintentionally narrow the scope of the definition.

BC52 After considering this feedback, the Board concluded that it would not be feasible to define the remaining terms in the definition of accounting policies within a narrow-scope project, and that the proposed changes to the definition could have unintended consequences. Because the amendments clarify what a change in accounting estimate is, the Board concluded that changing the definition of accounting policies was unnecessary to achieve the objective of the amendments and accordingly did not change that definition.

Selecting inventory cost formulas

BC53 When it exposed the draft amendments for comment, the Board proposed clarifying that, for ordinarily interchangeable inventories, selecting a cost formula (that is, first-in, first-out (FIFO) or weighted average cost) in applying IAS 2 *Inventories* constitutes selecting an accounting policy. However, some respondents to the draft amendments said selecting a cost formula could also be viewed as making an accounting estimate. The Board observed that paragraph 36(a) of IAS 2 already states that selecting a cost formula constitutes selecting an accounting policy. The Board did not revisit this conclusion in the light of the 2021 amendments because it observed that entities rarely change the cost formula used to measure inventories and, accordingly, there would be little benefit in the Board's doing so.

Illustrative Examples

Deletion of Example 3

BC54 The Board was informed that Example 3 from *Guidance on implementing IAS 8* could cause confusion because of the way it illustrated the accounting for particular changes in the accounting for property, plant and equipment. The Board concluded that addressing this matter would require a substantial rewrite of the example, for little or no benefit. Therefore, the Board deleted Example 3.

Addition of Examples 4–5

BC55 The draft amendments included no examples illustrating the application of the amendments. Respondents to the draft amendments and feedback from subsequent outreach suggested that providing illustrative examples would help entities understand and apply the amendments. In response to this feedback, the Board added two illustrative examples (Examples 4–5). The examples are simple and their aim is limited to helping stakeholders understand how to apply the definition of accounting estimates, rather than aiming to address specific application questions.

Effect analysis

BC56 The Board concluded that the expected benefits of the 2021 amendments outweigh the costs. In particular, the 2021 amendments made the requirements in IAS 8 clearer, and feedback on the draft proposals suggested that the amendments would help entities distinguish changes in accounting policies from changes in accounting estimates.

BC57 Nonetheless, the 2021 amendments might not solve all application questions identified by stakeholders. For example, they may not clarify in all situations whether a change results from:

(a) a change in an underlying measurement objective (which would be a change in accounting policy); or

(b) a change of the measurement technique applied to achieve the same underlying measurement objective (which would be a change in accounting estimate).

BC58 However, the Board concluded that when any uncertainty remains, it could be helpful for an entity to consider the requirement in paragraph 35. That requirement states that when it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the entity treats the change as a change in an accounting estimate.

Transition

BC59 The Board concluded that requiring an entity to apply prospectively the 2021 amendments appropriately balances expected benefits and costs. In particular, the Board assessed that the benefits of requiring an entity to apply the amendments to changes that occurred in a prior period would be minimal. Such changes would generally be non-recurring and restatement of comparative information would often not provide more useful trend information for users of financial statements.

Appendix

Amendments to the Guidance on implementing IAS 8 Definition of Accounting Estimates

The following sets out amendments required for this Implementation Guidance resulting from amendments to IAS 8 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted.

Example 3 is deleted and Examples 4–5 are added. In Example 3, deleted text is struck through and new text is underlined. In Examples 4–5, for ease of reading, new text has not been underlined.

Example 3 – Prospective application of a change in accounting policy when retrospective application is not practicable

[Deleted]

~~3.1~~ ~~During 20X2, Delta Co changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.~~

~~3.2~~ ~~In years before 20X2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.~~

~~3.3~~ ~~Delta's management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta's new policy prospectively from the start of 20X2.~~

~~3.4~~ ~~Additional information:~~

~~Delta's tax rate is 30 per cent.~~

	~~CU~~
~~Property, plant and equipment at the end of 20X1:~~	
~~Cost~~	~~25,000~~
~~Depreciation~~	~~(14,000)~~
~~Net book value~~	~~11,000~~
~~Prospective depreciation expense for 20X2 (old basis)~~	~~1,500~~

~~Some results of the engineering survey:~~

~~Valuation~~	~~17,000~~
~~Estimated residual value~~	~~3,000~~
~~Average remaining asset life (years)~~	~~7~~

~~Depreciation expense on existing property, plant and equipment for 20X2 (new basis)~~	~~2,000~~

~~Extract from the notes~~

~~1~~ ~~From the start of 20X2, Delta changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up to date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by CU6,000; increase the opening deferred tax provision by CU1,800; create a revaluation surplus at the start of the year of CU4,200; increase depreciation expense by CU500; and reduce tax expense by CU150.~~

Example 4 – Applying the definition of accounting estimates—Fair value of an investment property

Fact pattern

4.1 Entity A owns an investment property that it accounts for by applying the fair value model in IAS 40 *Investment Property*. Since it acquired the investment property, Entity A has been measuring the investment property's fair value using a valuation technique consistent with the income approach described in IFRS 13 *Fair Value Measurement.*

4.2 However, because of changes in market conditions since the previous reporting period, Entity A changes the valuation technique it uses to a valuation technique consistent with the market approach described in IFRS 13. Entity A has concluded that the resulting measurement is more representative of the investment property's fair value in the circumstances existing at the end of the current reporting period and, therefore, that IFRS 13 permits such a change. Entity A has also concluded that the change in the valuation technique is not a correction of a prior period error.

Applying the definition of accounting estimates

4.3 The fair value of the investment property is an accounting estimate because:

(a) the fair value of the investment property is a monetary amount in the financial statements that is subject to measurement uncertainty. Fair value reflects the price that would be received or paid in a hypothetical sale or purchase transaction between market participants—accordingly, it cannot be observed directly and must instead be estimated.

(b) the fair value of the investment property is an output of a measurement technique (a valuation technique) used in applying the accounting policy (fair value model).

(c) in developing its estimate of the fair value of the investment property, Entity A uses judgements and assumptions, for example, in:

(i) selecting the measurement technique—selecting the valuation technique that is appropriate in the circumstances; and

(ii) applying the measurement technique—developing the inputs that market participants would use in applying the valuation technique, such as information generated by market transactions involving comparable assets.

4.4 In this fact pattern, the change in the valuation technique is a change in the measurement technique applied to estimate the fair value of the investment property. The effect of this change is a change in an accounting estimate because the accounting policy—to measure the investment property at fair value—has not changed.

Example 5 – Applying the definition of accounting estimates—Fair value of a cash-settled share-based payment liability

Fact pattern

5.1 On 1 January 20X0, Entity A grants 100 share appreciation rights (SARs) to each of its employees, provided the employee remains in the entity's employment for the next three years. The SARs entitle the employees to a future cash payment based on the increase in the entity's share price over the three-year vesting period starting on 1 January 20X0.

5.2 Applying IFRS 2 *Share-based Payment,* Entity A accounts for the grant of the SARs as cash-settled share-based payment transactions—in doing so it recognises a liability for the SARs and measures that liability at its fair value (as defined by IFRS 2). Entity A applies the Black–Scholes–Merton formula (an option pricing model) to measure the fair value of the liability for the SARs at 1 January 20X0 and at the end of the reporting period.

5.3 At 31 December 20X1, because of changes in market conditions since the end of the previous reporting period, Entity A changes its estimate of the expected volatility of the share price—an input to the option pricing model—in estimating the fair value of the liability for the SARs at that date. Entity A has concluded that the change in that input is not a correction of a prior period error.

Applying the definition of accounting estimates

5.4 The fair value of the liability is an accounting estimate because:

(a) the fair value of the liability is a monetary amount in the financial statements that is subject to measurement uncertainty. That fair value is the amount for which the liability could be settled in a hypothetical transaction—accordingly, it cannot be observed directly and must instead be estimated.

(b) the fair value of the liability is an output of a measurement technique (option pricing model) used in applying the accounting policy (measuring a liability for a cash-settled share-based payment at fair value).

(c) to estimate the fair value of the liability, Entity A uses judgements and assumptions, for example, in:

(i) selecting the measurement technique—selecting the option pricing model; and

(ii) applying the measurement technique—developing the inputs that market participants would use in applying that option pricing model, such as the expected volatility of the share price and dividends expected on the shares.

5.5 In this fact pattern, the change in the expected volatility of the share price is a change in an input used to measure the fair value of the liability for the SARs at 31 December 20X1. The effect of this change is a change in accounting estimate because the accounting policy—to measure the liability at fair value—has not changed.

HKFRS Practice Statement 2
Issued ~~March~~ April 2021

Hong Kong Financial Reporting Standards Practice Statement 2

Making Materiality Judgements

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

HKFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) is set out in paragraphs 1–89 and the Appendix. This Practice Statement should be read in the context of its objective and Basis for Conclusions, as well as in the context of the *Preface to HKFRS Standards*, the *Conceptual Framework for Financial Reporting* and HKFRS Standards.

Appendix
Amendments to Disclosure of Accounting Policies

The following sets out amendments required for this Practice Statement resulting from amendments to HKAS 1 that are not yet effective. Once the amendments to HKAS 1 effective, the amendments set out below will be incorporated into the text of this Practice Statement and this appendix will be deleted.

Paragraphs 88A–88G and their heading, and Examples S and T, are added. Paragraphs 117, 117A, 117B, 117C, 117D and 117E of HKAS 1 are added to the Appendix. For ease of reading new text is not underlined.

Specific topics

...

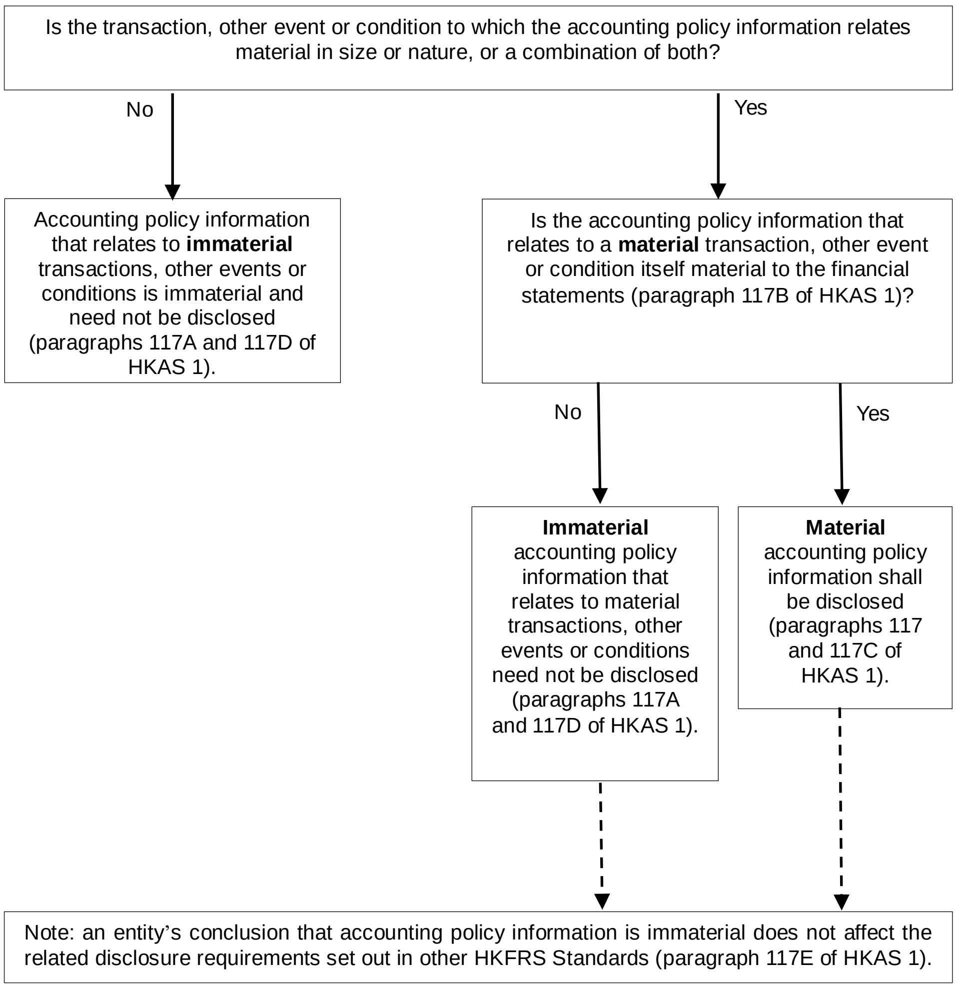
Information about accounting policies

88A Paragraph 117 of HKAS 1 requires an entity to disclose material accounting policy information.

88B Accounting policy information relating to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may nevertheless be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial. An entity is required to disclose accounting policy information relating to material transactions, other events or conditions if that information is material to the financial statements.

88C In assessing whether accounting policy information is material to its financial statements, an entity considers whether users of the entity's financial statements would need that information to understand other material information in the financial statements. An entity makes this assessment in the same way it assesses other information: by considering qualitative and quantitative factors, as described in paragraphs 44–55. Diagram 2 illustrates how an entity assesses whether accounting policy information is material and, therefore, shall be disclosed.

Diagram 2—determining whether accounting policy information is material



88D Paragraph 117B of HKAS 1 includes examples of circumstances in which an entity is likely to consider accounting policy information to be material to its financial statements. The list is not exhaustive, but provides guidance on when an entity would normally consider accounting policy information to be material.

88E Paragraph 117C of HKAS 1 describes the type of material accounting policy information that users of financial statements find most useful. Users generally find information about the characteristics of an entity's transactions, other events or conditions—entity-specific information—more useful than disclosures that only include standardised information, or information that duplicates or summarises the requirements of the HKFRS Standards. Entity-specific accounting policy information is particularly useful when that information relates to an area for which an entity has exercised judgement—for example, when an entity applies an HKFRS Standard differently from similar entities in the same industry.

88F Although entity-specific accounting policy information is generally more useful, material accounting policy information could sometimes include information that is standardised, or that duplicates or summarises the requirements of the HKFRS Standards. Such information may be material if, for example:

(a) users of the entity's financial statements need that information to understand other material information provided in the financial statements. Such a scenario might arise when an entity applying HKFRS 9 *Financial Instruments* has no choice regarding the classification of its financial instruments. In such scenarios, users of that entity's financial statements may only be able to understand how the entity has accounted for its material financial instruments if users also understand how the entity has applied the requirements of HKFRS 9 to its financial instruments.

(b) an entity reports in a jurisdiction in which entities also report applying local accounting standards.

(c) the accounting required by the HKFRS Standards is complex, and users of financial statements need to understand the required accounting. Such a scenario might arise when an entity accounts for a material class of transactions, other events or conditions by applying more than one HKFRS Standard.

88G Paragraph 117D of HKAS 1 states that if an entity discloses immaterial accounting policy information, such information shall not obscure material information. Paragraphs 56–59 provide guidance about how to communicate information clearly and concisely in the financial statements.

Example S—making materiality judgements and focusing on entity-specific information while avoiding standardised (boilerplate) accounting policy information

Background

An entity operates within the telecommunications industry. It has entered into contracts with retail customers to deliver mobile phone handsets and data services. In a typical contract, the entity provides a customer with a handset and data services over three years. The entity applies HKFRS 15 *Revenue from Contracts with Customers* and recognises revenue when, or as, the entity satisfies its performance obligations in line with the terms of the contract.

The entity has identified two performance obligations and related considerations:

(a) the handset—the customer makes monthly payments for the handset over three years; and

(b) data—the customer pays a fixed monthly charge to use a specified monthly amount of data over three years.

For the handset, the entity concludes that it should recognise revenue when it satisfies the performance obligation (when it provides the handset to the customer). For the provision of data, the entity concludes that it should recognise revenue as it satisfies the performance obligation (as the entity provides data services to the customer over the three-year life of the contract).

The entity notes that, in accounting for revenue it has made judgements about:

(a) the allocation of the transaction price to the performance obligations; and

(b) the timing of satisfaction of the performance obligations.

The entity has concluded that revenue generated from these contracts is material to the reporting period.

Application

The entity notes that for contracts of this type it applies separate accounting policies for two sources of revenue, namely revenue from:

(a) the sale of handsets; and

(b) the provision of data services.

Having identified revenue from contracts of this type as material to the financial statements, the entity assesses whether accounting policy information for revenue from these contracts is, in fact, material.

The entity evaluates the effect of disclosing the accounting policy information by considering the presence of qualitative factors. The entity noted that its revenue recognition accounting policies:

(a) were unchanged during the reporting period;

(b) were not chosen from accounting policy options available in the HKFRS Standards;

(c) were not developed in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an HKFRS Standard that specifically applies; and

(d) are not so complex that primary users will be unable to understand the related revenue transactions without standardised descriptions of the requirements of HKFRS 15.

However, some of the entity's revenue recognition accounting policies relate to an area for which the entity has made significant judgements in applying its accounting policies—for example, in deciding how to allocate the transaction price to the performance obligations, and the timing of revenue recognition.

The entity considers that, in addition to disclosing the information required by paragraphs 123–126 of HKFRS 15 about the significant judgements made in applying HKFRS 15, primary users of its financial statements are likely to need to understand related accounting policy information. Consequently, the entity concludes that such accounting policy information could reasonably be expected to influence the decisions of the primary users of its financial statements. For example, understanding:

(a) how the entity allocates the transaction price to its performance obligations is likely to help users understand how each component of the transaction contributes to the entity's revenue and cash flows; and

(b) that some revenue is recognised at a point in time and some is recognised over time is likely to help users understand how reported cash flows relate to revenue.

The entity also notes that the judgements it made are specific to the entity. Consequently, material accounting policy information would include information about how the entity has applied the requirements of HKFRS 15 to its specific circumstances.

The entity, therefore, assesses that accounting policy information about revenue recognition is material and should be disclosed. Such disclosure would include information about how the entity allocates the transaction price to its performance obligations and when the entity recognises revenue.

Example T—making materiality judgements on accounting policy information that only duplicates requirements in the HKFRS Standards

Background

Property, plant and equipment are material to an entity's financial statements.

The entity has no intangible assets or goodwill and has not recognised an impairment loss on its property, plant or equipment in either the current or comparative reporting periods.

In previous reporting periods, the entity disclosed accounting policy information relating to impairment of non-current assets which duplicates the requirements of HKAS 36 *Impairment of Assets* and provides no entity-specific information. The entity disclosed that:

> The carrying amounts of the group's intangible assets and its property, plant and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangibles with an indefinite useful life, the recoverable amount is estimated at least annually.
>
> An impairment loss is recognised in the statement of profit or loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.
>
> The recoverable amount of assets is the greater of their fair value less costs to sell and their value in use. In measuring value in use, estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.
>
> Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to that cash-generating unit and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.
>
> An impairment loss in respect of goodwill is not subsequently reversed. For other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, but only to the extent that the new carrying amount does not exceed the carrying amount that would have been determined, net of depreciation and amortisation, if no impairment loss had been recognised.

Application

Having identified assets subject to impairment testing as being material to the financial statements, the entity assesses whether the accounting policy information for impairment is, in fact, material.

As part of its assessment, the entity considers that an impairment or a reversal of an impairment had not occurred in the current or comparative reporting periods. Consequently, accounting policy information about how the entity recognises and allocates impairment losses is unlikely to be material to its primary users. Similarly, because the entity has no intangible assets or goodwill, information about its accounting policy for impairments of intangible assets and goodwill is unlikely to provide its primary users with material information.

However, the entity's impairment accounting policy relates to an area for which the entity is required to make significant judgements or assumptions, as described in paragraphs 122 and 125 of HKAS 1. Given the entity's specific circumstances, it concludes that information about its significant judgements and assumptions related to its impairment assessments could reasonably be expected to influence the decisions of the primary users of the entity's financial statements. The entity notes that its disclosures about significant judgements and assumptions already include information about the significant judgements and assumptions used in its impairment assessments.

The entity decides that the primary users of its financial statements would be unlikely to need to understand the recognition and measurement requirements of HKAS 36 to understand related information in the financial statements.

Consequently, the entity concludes that disclosing a summary of the requirements in HKAS 36 in a separate accounting policy for impairment would not provide information that could reasonably be expected to influence decisions made by the primary users of its financial statements. Instead, the entity discloses material accounting policy information related to the significant judgements and assumptions the entity has applied in its impairment assessments elsewhere in the financial statements.

Although the entity assesses some accounting policy information for impairments of assets as immaterial, the entity still assesses whether other disclosure requirements of HKAS 36 provide material information that should be disclosed.

...

Appendix
References to the *Conceptual Framework for Financial Reporting* and HKFRS Standards

...

Extracts from HKAS 1 *Presentation of Financial Statements*

…

Paragraph 117

Referred to in paragraphs 88A and 88C of the Practice Statement

An entity shall disclose material accounting policy information (see paragraph 7). Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.

Paragraph 117A

Referred to in paragraph 88C of the Practice Statement

Accounting policy information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may nevertheless be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial. However, not all accounting policy information relating to material transactions, other events or conditions is itself material.

Paragraph 117B

Referred to in paragraphs 88C and 88D of the Practice Statement

Accounting policy information is expected to be material if users of an entity's financial statements would need it to understand other material information in the financial statements. For example, an entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, other events or conditions and:

(a) the entity changed its accounting policy during the reporting period and this change resulted in a material change to the information in the financial statements;

(b) the entity chose the accounting policy from one or more options permitted by HKFRSs—such a situation could arise if the entity chose to measure investment property at historical cost rather than fair value;

(c) the accounting policy was developed in accordance with HKAS 8 in the absence of a HKFRS that specifically applies;

(d) the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions in accordance with paragraphs 122 and 125; or

(e) the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events or conditions—such a situation could arise if an entity applies more than one HKFRS to a class of material transactions.

Paragraph 117C

Referred to in paragraphs 88C and 88E of the Practice Statement

Accounting policy information that focuses on how an entity has applied the requirements of the HKFRSs to its own circumstances provides entity-specific information that is more useful to users of financial statements than standardised information, or information that only duplicates or summarises the requirements of the HKFRSs.

Paragraph 117D

Referred to in paragraphs 88C and 88G of the Practice Statement

If an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information.

Paragraph 117E

Referred to in paragraph 88C of the Practice Statement

An entity's conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other HKFRSs.

...

Appendix
Amendments to the Basis for Conclusions on Disclosure of Accounting Policies

This appendix contains amendments to the Basis for Conclusions on IFRS Practice Statement 2 resulting from amendments to IAS 1 that are not yet effective. Once the amendments to IAS 1 effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted.

Paragraphs BC41A–BC41F and their related heading are added. Dissenting opinion is added. For ease of reading new text is not underlined.

Specific topics

...

Materiality judgements for accounting policy information (see paragraphs BC76H–BC76AB of IAS 1)

BC41A In February 2021 the Board amended IAS 1 to require an entity to disclose its material accounting policy information rather than its significant accounting policies.

BC41B To help entities to apply the amendments to IAS 1, the Board also amended IFRS Practice Statement 2 to illustrate how an entity can judge whether accounting policy information is material to its financial statements.

BC41C The Board added guidance and examples to IFRS Practice Statement 2 to help an entity apply the four-step materiality process to accounting policy information. The guidance and examples help an entity apply the amendments to IAS 1 by:

(a) confirming that in assessing whether accounting policy information is material, an entity considers both qualitative and quantitative factors (see paragraph 88C);

(b) linking materiality judgements to accounting policy disclosures using the four-step materiality process described in paragraph 33 (see paragraph 88C).

(c) emphasising the need to focus on useful information for users of financial statements (see paragraphs 88C–88E); and

(d) demonstrating how an entity can apply the four-step materiality process to address:

  (i) standardised (boilerplate) information disclosed as part of material accounting policy information (see Example S); and

  (ii) accounting policy information that only duplicates or summarises the requirements of IFRS Standards (see Example T).

BC41D Examples S and T are intended only to illustrate the application of the amendments to IAS 1 and the four-step materiality process to accounting policy information. They do not illustrate the application of the definition of material to all disclosure requirements of IFRS 15 *Revenue from Contracts with Customers* and IAS 36 *Impairment of Assets*. An entity is also required to comply with the other disclosure requirements of those IFRS Standards.

BC41E The Board concluded that accounting policy information that includes standardised information, or that duplicates or summarises some of the requirements of IFRS Standards, could sometimes be material. The Board added guidance about when such accounting policy information might be material to an entity's financial statements (see paragraph 88F).

BC41F The Board concluded that, as the amendments provide non-mandatory guidance on the application of the definition of material to accounting policy information, transition requirements and an effective date for these amendments are unnecessary.

Dissenting opinion

Dissent of Ms Françoise Flores from *Disclosure of Accounting Policies*

DO1 Ms Flores voted against the publication of *Disclosure of Accounting Policies*, which amends IAS 1 and IFRS Practice Statement 2. The reasons for her dissent are set out below.

DO2 Ms Flores agrees with those amendments to IAS 1 and IFRS Practice Statement 2 which aim to provide primary users of financial statements with all and only relevant accounting policy information. She also supports the Board's past and current efforts to clarify how the concept of materiality should be applied more generally. She agrees with all the amendments except paragraph 117B(e) of IAS 1 and paragraph 88F of IFRS Practice Statement 2.

DO3 In particular, Ms Flores disagrees with paragraph 117B(e) of IAS 1, which implies that accounting policy information that includes information that is standardised or duplicates the requirements of IFRS Standards could be material when the underlying accounting is complex; and that, therefore, such information is required to be included in the financial statements. Ms Flores believes that the notion of complexity is highly subjective and, therefore, does not constitute a robust basis for a requirement. Introducing such a subjective assessment could, in her view, undermine the overall aim of the amendments, which is to contribute to a better application of the concept of materiality to accounting policy disclosures and thereby help an entity reduce the disclosure of immaterial accounting policy information. Facing such subjective judgements, an entity may opt for 'being on the safe side', providing more information than is required. In her view, paragraph 117B(e) of IAS 1 is an unsatisfactory response to feedback from users of financial statements who said they find entity-specific accounting policy information to be more useful than information that is standardised or that duplicates or summarises the requirements of IFRS Standards.

DO4 A minority of respondents were concerned that the Board's proposals could be read as prohibiting the publication of any accounting policy information that is standardised, or that duplicates or summarises the requirements of IFRS Standards. Ms Flores believes that the appropriate response would have been to explain that such accounting policy information may, in some circumstances, be useful in providing context for entity-specific information. Such an approach would enhance the readability of entity-specific accounting policy information.

DO5 Furthermore, Ms Flores notes that paragraph 2.36 of the *Conceptual Framework of Financial Reporting*, paragraph 7 of IAS 1 and the guidance included in paragraphs 13–23 of IFRS Practice Statement 2 state that users of financial statements are expected to have a reasonable knowledge of business and economic activities, but may need to seek the aid of an adviser to cope with perceived complexity. In her view, investors are responsible for ensuring that their economic decisions are derived from a proper and knowledgeable understanding of an entity's financial statements, which includes understanding the requirements of IFRS Standards. IFRS Standards should be regarded as public knowledge in a financial reporting environment. No mere recitation of the words from the IFRS Standards can meet the definition of material without stretching that definition endlessly. In Ms Flores' view, improving users' understanding of the requirements in IFRS Standards should be achieved through education by the IFRS Foundation. Such an objective should not be achieved by amending the requirements of IFRS Standards.