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

MEMBERS' HANDBOOK

Update No. 139

(Issued 26 February 2014)

Handbook Improvements only

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

VOLUME II

Contents of Volume II	Insert the revised pages i - iii. Discard the replaced pages i - iii.	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 2 Inventories	Replace the cover page and pages 2-4, 9 and 15 with revised cover page and pages 2-4, 9 and 15	Amendments due to - HKFRS 13 *Fair Value Measurement*
HKAS 7 *Statement of Cash Flows*	Replace the cover page and pages 2-3 and 9-12 with revised cover page and pages 2-3 and 9-12	Amendments due to - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements*
HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*	Replace the cover page and pages 2-4, 10-11, 19, 24 and 26 with revised cover page and pages 2-4, 10-11, 19, 24 and 26	Amendments due to - HKFRS 13 *Fair Value Measurement*

HKAS 10 *Events after the Reporting Period*	Replace the cover page and pages 2-4, 8 and 11 with revised cover page and pages 2-4, 8 and 11	Amendments due to - HKFRS 13 *Fair Value Measurement*
HKAS 16 *Property, Plant and Equipment*	Replace the Standard and Basis for Conclusions with revised Standard and Basis for Conclusions	Amendments due to - HKFRS 13 *Fair Value Measurement* - *Annual Improvements 2009-2011 Cycle*
HKAS 17 *Leases*	Replace the cover page and pages 2-4, 9 and 22-23 with revised cover page and pages 2-4, 9 and 22-23	Amendments due to - HKFRS 13 *Fair Value Measurement*
HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*	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 13 *Fair Value Measurement*
HKAS 24 (Revised) *Related Party Disclosures*	Replace the Standard, Basis for Conclusions and Illustrative Examples with revised Standard, Basis for Conclusions and Illustrative Examples	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 12 *Disclosure of Interests in Other Entities*
HKAS 34 *Interim Financial Reporting*	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) - HKAS 19 *Employee Benefits* (2011) - HKFRS 13 *Fair Value Measurement* - *Annual Improvements 2009-2011 Cycle*

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

HK(IFRIC) - Int 2 *Members' Shares in Cooperative Entities and Similar Instruments*	Replace the Interpretation and Basis for Conclusions with revised Interpretation and Basis for Conclusions	Amendments due to - HKFRS 13 *Fair Value Measurement* - *Annual Improvements 2009-2011 Cycle*
HK(IFRIC) - Int 4 *Determining whether an Arrangement contains a Lease*	Replace the cover page and pages 2-4, 7 and 13-14 with revised cover page and pages 2-4, 7 and 13-14. Discard the existing page 19.	Amendments due to - HKFRS 10 *Consolidated Financial Statements* - HKFRS 13 *Fair Value Measurement*
HK(IFRIC) - Int 5 *Rights to Interests arising from Decommissioning, Restoration and Environment Rehabilitation Funds*	Replace the Interpretation and Basis for Conclusions with revised Interpretation and Basis for Conclusions	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements*
HK(IFRIC) - Int 9 *Reassessment of Embedded Derivatives*	Replace the Interpretation and Basis for Conclusions with revised Interpretation and Basis for Conclusions	Amendments due to - HKFRS 11 *Joint Arrangements*
HK(IFRIC) - Int 12 *Service Concession Arrangements*	Replace the cover page and pages 2-4, 18, 22, 29 and 38 with revised cover page and pages 2-4, 18, 22, 29 and 38	Amendments due to - HKFRS 13 *Fair Value Measurement*
HK(IFRIC) - Int 13 *Customer Loyalty Programmes*	Replace the cover page and pages 1A and 2-7 with revised cover page and pages 1A, 2-7	Amendments due to - HKFRS 13 *Fair Value Measurement*

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MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to February 2014)

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

HKAS 2
Revised ~~July 2012~~February 2014

Effective for annual periods beginning
on or after 1 January 2005

Hong Kong Accounting Standard 2

Inventories

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Hong Kong Accounting Standard 2 *Inventories* (HKAS 2) is set out in paragraphs 1-42 and Appendix C. All the paragraphs have equal authority. HKAS 2 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of Financial Statements~~ Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

5 Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

Definitions

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

Inventories **are assets:**

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

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

~~*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.**~~*Fair value* **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*)**

7 Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. ~~Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace~~Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

8 Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the entity and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in paragraph 19, for which the entity has not yet recognised the related revenue (see HKAS 18 *Revenue*).

Measurement of inventories

9 Inventories shall be measured at the lower of cost and net realisable value.

Cost of inventories

10 The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

40a 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.

40A *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

40B *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

40C HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 6 and amended paragraph 7. An entity shall apply those amendments when it applied HKFRS 13.

Withdrawal of other pronouncements

41 This Standard supersedes SSAP 22 *Inventories*, revised in 2001.

42 [Not used]

HKAS 7
Revised ~~January 2010~~February 2014

Hong Kong Accounting Standard 7

Statement of Cash Flows

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from paragraph

Hong Kong Accounting Standard 7
STATEMENT OF CASH FLOWS

Hong Kong Accounting Standard 7 *Statement of Cash Flows* (HKAS 7) is set out in paragraphs 1-~~56~~57. All the paragraphs have equal authority. HKAS 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 ~~the Preparation and Presentation of Financial Statements~~ Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

28 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

29 [Deleted]

30 [Deleted]

Interest and dividends

31 Cash flows from interest and dividends received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as either operating, investing or financing activities.

32 The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with HKAS 23 *Borrowing Costs*.

33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. Alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

34 Dividends paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an entity to pay dividends out of operating cash flows.

Taxes on income

35 Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

36 Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Investments in subsidiaries, associates and joint ventures

37 When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

38 ~~An entity which reports its interest in a jointly controlled entity (see HKAS 31~~ ~~*Interests in Joint Ventures*)~~ ~~using proportionate consolidation, includes in its consolidated statement of cash flows its proportionate share of the jointly controlled entity's cash flows.~~ An entity ~~which~~ that reports ~~such~~ its ~~an~~ interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the ~~jointly controlled entity~~associate or joint venture, and distributions and other payments or receipts between it and the ~~jointly controlled entity~~associate or joint venture.

Changes in ownership interests in subsidiaries and other businesses

39 The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

40 An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:

(a) the total consideration paid or received;

(b) the portion of the consideration consisting of cash and cash equivalents;

(c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and

(d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

41 The separate presentation of the cash flow effects of obtaining or losing control of subsidiaries or other businesses as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of losing control are not deducted from those of obtaining control.

42 The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

42A Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities.

42B Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see ~~HKAS 27~~HKFRS 10 *Consolidated* ~~*and Separate*~~ *Financial Statements* ~~(as amended in 2008)~~). Accordingly, the resulting cash flows are classified in the same way as other transactions with owners described in paragraph 17.

Non-cash transactions

43 Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

44 Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows as these items do not involve cash flows in the current period. Examples of non-cash transactions are:

(a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;

(b) the acquisition of an entity by means of an equity issue; and

(c) the conversion of debt to equity.

Components of cash and cash equivalents

45 An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the statement of financial position.

46 In view of the variety of cash management practices and banking arrangements around the world and in order to comply with HKAS 1 *Presentation of Financial Statements*, an entity discloses the policy which it adopts in determining the composition of cash and cash equivalents.

47 The effect of any change in the policy for determining components of cash and cash equivalents, for example, a change in the classification of financial instruments previously considered to be part of an entity's investment portfolio, is reported in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Other disclosures

48 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

49 There are various circumstances in which cash and cash equivalent balances held by an entity are not available for use by the group. Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.

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

(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;

(b) ~~the aggregate amounts of the cash flows from each of operating, investing and financing activities related to interests in joint ventures reported using proportionate consolidation;~~[deleted]

(c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and

(d) the amount of the cash flows arising from the operating, investing and financing activities of each reportable segment (see HKFRS 8 *Operating Segments*).

51 The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the entity is investing adequately in the maintenance of its operating capacity. An entity that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.

52 The disclosure of segmental cash flows enables users to obtain a better understanding of the relationship between the cash flows of the business as a whole and those of its component parts and the availability and variability of segmental cash flows.

Effective date

53 This Hong Kong Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged.

54 HKAS 27 (as amended in 2008) amended paragraphs 39 – 42 and added paragraphs 42A and 42B. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period. The amendments shall be applied retrospectively.

55 Paragraph 14 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 paragraph 68A of HKAS 16.

56 Paragraph 16 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.

57 HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 37, 38 and 42B and deleted paragraph 50(b). An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 8
Revised ~~July 2012~~February 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Accounting Standard 8

Accounting Policies, Changes in Accounting Estimates and Errors

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APPENDICES:

A Comparison with International Accounting Standards

B Amendments to other pronouncements

C Amendments resulting from other HKFRSs

BASIS FOR CONCLUSIONS

IMPLEMENTATION GUIDANCE

TABLE OF CONCORDANCE

Hong Kong Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (HKAS 8) is set out in paragraphs 1-56 and Appendix C. 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 ~~the Preparation and Presentation of Financial Statement~~ Financial Reporting*.

Prospective application **of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:**

(a) **applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and**

(b) **recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.**

6 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.

Accounting policies

Selection and application of accounting policies

7 **When a HKFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the HKFRS.**

8 HKFRSs set out accounting policies that the HKICPA has concluded result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from HKFRSs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

9 HKFRSs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of HKFRSs. Guidance that is an integral part of HKFRSs is mandatory. Guidance that is not an integral part of HKFRSs does not contain requirements for financial statements.

10 **In the absence of a HKFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:**

(a) **relevant to the economic decision-making needs of users; and**

* 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.*

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

11 **In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:**

(a) the requirements in HKFRSs dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*[+]**.**

12 **In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature[*] and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.**

Consistency of accounting policies

13 **An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a HKFRS specifically requires or permits categorisation of items for which different policies may be appropriate. If a HKFRS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.**

Changes in accounting policies

14 **An entity shall change an accounting policy only if the change:**

(a) is required by a HKFRS; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

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

[*] In the context of Hong Kong, other accounting literature includes Accounting Guidelines and Accounting Bulletins.

(b) would have been available when the financial statements for that prior period were authorised for issue

from other information. For some types of estimates (eg ~~an estimate of~~ a fair value ~~not~~ measurement that uses significant unobservable~~based on an observable price or observable~~ inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in measuring financial assets previously classified as held-to-maturity investments in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with HKAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Effective date

54 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.

54a 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.

54A *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

54B *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

54C HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended paragraph 52. An entity shall apply that amendment when it applies HKFRS 13.

Withdrawal of other pronouncements

55 This Standard supersedes SSAP 2 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, revised in 2001.

56 [Not used]

BC6 The Board identified the removal of optional treatments for changes in accounting policies and corrections of errors as an important improvement to the previous version of IAS 8. The Standard removes the allowed alternative treatments and requires changes in accounting policies and corrections of prior period errors to be accounted for retrospectively.

BC7 The Board concluded that retrospective application made by amending the comparative information presented for prior periods is preferable to the previously allowed alternative treatments because, under the now required method of retrospective application:

(a) profit or loss for the period of the change does not include the effects of changes in accounting policies or errors relating to prior periods.

(b) information presented about prior periods is prepared on the same basis as information about the current period, and is therefore comparable. This information possesses a qualitative characteristic identified in the *Framework for the Preparation and Presentation of Financial Statements*[*], and provides the most useful information for trend analysis of income and expenses.

(c) prior period errors are not repeated in comparative information presented for prior periods.

BC8 Some respondents to the Exposure Draft argued that the previously allowed alternative treatments are preferable because:

(a) correcting prior period errors by restating prior period information involves an unjustifiable use of hindsight;

(b) recognising the effects of changes in accounting policies and corrections of errors in current period profit or loss makes them more prominent to users of financial statements; and

(c) each amount credited or debited to retained earnings as a result of an entity's activities has been recognised in profit or loss in some period.

BC9 The Board concluded that restating prior period information to correct a prior period error does not involve an unjustifiable use of hindsight because prior period errors are defined in terms of a failure to use, or misuse of, reliable information that was available when the prior period financial statements were authorised for issue and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

BC10 The Board also concluded that the disclosures about changes in accounting policies and corrections of prior period errors in paragraphs 28, 29 and 49 of the Standard should ensure that their effects are sufficiently prominent to users of financial statements.

BC11 The Board further concluded that it is less important for each amount credited or debited to retained earnings as a result of an entity's activities to be recognised in profit or loss in some period than for the profit or loss for each period presented to represent faithfully the effects of transactions and other events occurring in that period.

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[*] 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*.

BC17 As proposed in the Exposure Draft, the Standard states that pronouncements of other standard-setting bodies are used only if they do not conflict with:

(a) the requirements and guidance in IFRSs dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*[*].

BC18 The Standard refers to the most recent pronouncements of other standard-setting bodies because if pronouncements are withdrawn or superseded, the relevant standard-setting body no longer thinks they include the best accounting policies to apply.

BC19 Comments received indicated that it was unclear from the Exposure Draft whether a change in accounting policy following a change in a pronouncement of another standard-setting body should be accounted for under the transitional provisions in that pronouncement. As noted above, the Standard does not mandate using pronouncements of other standard-setting bodies in any circumstances. Accordingly, the Board decided to clarify that such a change in accounting policy is accounted for and disclosed as a voluntary change in accounting policy (see paragraph 21 of the Standard). Thus, an entity is precluded from applying transitional provisions specified by the other standard-setting body if they are inconsistent with the treatment of voluntary changes in accounting policies specified by the Standard.

Materiality

BC20 The Standard states that accounting policies specified by IFRSs need not be applied when the effect of applying them is immaterial. It also states that financial statements do not comply with IFRSs if they contain material errors, and that material prior period errors are to be corrected in the first set of financial statements authorised for issue after their discovery. The Standard includes a definition of material omissions or misstatements, which is based on the description of materiality in IAS 1 *Presentation of Financial Statements* (as issued in 1997) and in the *Framework*.

BC21 The former *Preface to Statements of International Accounting Standards* stated that International Accounting Standards were not intended to apply to immaterial items. There is no equivalent statement in the *Preface to International Financial Reporting Standards*. The Board received comments that the absence of such a statement from the *Preface* could be interpreted as requiring an entity to apply accounting policies (including measurement requirements) specified by IFRSs to immaterial items. However, the Board decided that the application of the concept of materiality should be in Standards rather than in the *Preface*.

BC22 The application of the concept of materiality is set out in two Standards. IAS 1 (as revised in 2007) continues to specify its application to disclosures. IAS 8 specifies the application of materiality in applying accounting policies and correcting errors (including errors in measuring items).

[*] In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting.*

Hong Kong Accounting Standard 10

Events after the Reporting Period

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Hong Kong Accounting Standard 10 *Events after the Reporting Period* (HKAS 10) is set out in paragraphs 1-24. All the paragraphs have equal authority. HKAS 10 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of Financial Statements~~Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

(a) the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or recognises a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of HKAS 37.

(b) the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:

    (i) the bankruptcy of a customer that occurs after the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the entity needs to adjust the carrying amount of the trade receivable; and

    (ii) the sale of inventories after the reporting period may give evidence about their net realisable value at the end of the reporting period.

(c) the determination after the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

(d) the determination after the reporting period of the amount of profit sharing or bonus payments, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments as a result of events before that date (see HKAS 19 *Employee Benefits*).

(e) the discovery of fraud or errors that show that the financial statements are incorrect.

Non-adjusting events after the reporting period

10 An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period.

11 An example of a non-adjusting event after the reporting period is a decline in ~~market~~ fair value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in ~~market~~ fair value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure under paragraph 21.

(g) abnormally large changes after the reporting period in asset prices or foreign exchange rates;

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

(i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and

(j) commencing major litigation arising solely out of events that occurred after the reporting period.

Effective date

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

23a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

23A HKFRS 13, issued in June 2011, amended paragraph 11. An entity shall apply that amendment when it applies HKFRS 13.

Withdrawal of SSAP 9 (revised 2001)

24 This Standard supersedes SSAP 9 *Events After the Balance Sheet Date* revised in 2001.

HKAS 16
Revised ~~June 2012~~February 2014

Hong Kong Accounting Standard 16

Property, Plant and Equipment

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

CONTENTS
HONG KONG ACCOUNTING STANDARD 16
PROPERTY, PLANT AND EQUIPEMENT

Hong Kong Accounting Standard 16 *Property, Plant and Equipment* (HKAS 16) is set out in paragraphs 1-83 and Appendix B. All the paragraphs have equal authority. HKAS 16 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong 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 16 *Property, Plant and Equipment* (HKAS 16) should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged.

Reasons for issuing HKAS 16

IN2 The objectives of Hong Kong Institute of Certified Public Accountants (HKICPA) issuing HKAS 16 were to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements.

IN3 For HKAS 16 the HKICPA's main objective was a limited revision to provide additional guidance and clarification on selected matters. The HKICPA did not reconsider the fundamental approach to the accounting for property, plant and equipment contained in HKAS 16.

The main features

IN4 The main features of HKAS 16 are described below.

Scope

IN5 This Standard clarifies that an entity is required to apply the principles of this Standard to items of property, plant and equipment used to develop or maintain (a) biological assets and (b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Recognition: subsequent costs

IN6 An entity evaluates under the general recognition principle all property, plant and equipment costs at the time they are incurred. Those costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service an item.

Measurement at recognition: asset dismantlement, removal and restoration costs

IN7 The cost of an item of property, plant and equipment includes the costs of its dismantlement, removal or restoration, the obligation for which an entity incurs as a consequence of installing the item. Its cost also includes the costs of its dismantlement, removal or restoration, the obligation for which an entity incurs as a consequence of using the item during a particular period for purposes other than to produce inventories during that period.

Measurement at recognition: asset exchange transactions

IN8 An entity is required to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance.

Measurement after recognition: revaluation model

IN9 If fair value can be measured reliably, an entity may carry all items of property, plant and equipment of a class at a revalued amount, which is the fair value of the items at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses.

Depreciation: unit of measure

IN10 An entity is required to determine the depreciation charge separately for each significant part of an item of property, plant and equipment.

Depreciation: depreciable amount

IN11 An entity is required to measure the residual value of an item of property, plant and equipment as the amount it estimates it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life.

Depreciation: depreciation period

IN12 An entity is required to begin depreciating an item of property, plant and equipment when it is available for use and to continue depreciating it until it is derecognised, even if during that period the item is idle.

Derecognition: derecognition date

IN13 An entity is required to derecognise the carrying amount of an item of property, plant and equipment that it disposes of on the date the criteria for the sale of goods in HKAS 18 *Revenue* would be met.

IN14 An entity is required to derecognise the carrying amount of a part of an item of property, plant and equipment if that part has been replaced and the entity has included the cost of the replacement in the carrying amount of the item.

Derecognition: gain classification

IN15 An entity cannot classify as revenue a gain it realises on the disposal of an item of property, plant and equipment.

Hong Kong Accounting Standard 16
Property, Plant and Equipment

Objective

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

Scope

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

3 This Standard does not apply to:

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

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

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

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

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

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

5 An entity using the cost model for investment property in accordance with HKAS 40 *Investment Property* shall use the cost model in this Standard.

Definitions

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

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

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

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

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

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

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

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

Property, plant and equipment **are tangible items that:**

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

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

Recoverable amount **is the higher of an asset's fair value less costs to sell and its value in use.**

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

Useful life **is:**

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

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

Recognition

7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

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

8. ~~Spare~~Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this HKFRS~~are usually carried as inventory and recognised in profit or loss as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment~~ when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.~~an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.~~

9 This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.

10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

Initial costs

11 Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with HKAS 36 *Impairment of Assets*.

Subsequent costs

12 Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67-72).

14 A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Measurement at recognition

15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Elements of cost

16 The cost of an item of property, plant and equipment comprises:

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

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17 Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in HKAS 19 *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

18 An entity applies HKAS 2 *Inventories* to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with HKAS 2 or HKAS 16 are recognised and measured in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

19 Examples of costs that are not costs of an item of property, plant and equipment are:

(a) costs of opening a new facility;

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

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

(d) administration and other general overhead costs.

20 Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) initial operating losses, such as those incurred while demand for the item's output builds up; and

(c) costs of relocating or reorganising part or all of an entity's operations.

21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

22 The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see HKAS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. HKAS 23 *Borrowing Costs* establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

Measurement of cost

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

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

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

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

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

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

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

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

27 The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with HKAS 17.

28 The carrying amount of an item of property, plant and equipment may be reduced by government grants in accordance with HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

Measurement after recognition

29 **An entity shall choose either the cost model in paragraph 30 or the revaluation model in paragraph 31 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.**

Cost model

30 **After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.**

Revaluation model

31 **After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.**

32 [Deleted]~~The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers. The fair value of items of plant and equipment is usually their market value determined by appraisal.~~

33 [Deleted]~~If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach.~~

34 The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

35 When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:

(a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to determine its ~~depreciated~~ replacement cost (see HKFRS13).

(b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 39 and 40.

36 **If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.**

37 A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. The following are examples of separate classes:

(a) land;

(b) land and buildings;

(c) machinery;

(d) ships;

(e) aircraft;

(f) motor vehicles;

(g) furniture and fixtures; and

(h) office equipment.

38 The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.

39 If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

40 If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

41 The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

42 The effects of taxes on income, if any, resulting from the revaluation of property, plant and equipment are recognised and disclosed in accordance with HKAS 12 *Income Taxes*.

Depreciation

43 Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

44 An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease. Similarly, if an entity acquires property, plant and equipment subject to an operating lease in which it is the lessor, it may be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favourable or unfavourable lease terms relative to market terms.

45 A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

46 To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

47 An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.

48 The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset.

49 The depreciation charge for a period is usually recognised in profit or loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see HKAS 2). Similarly, depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with HKAS 38 *Intangible Assets*.

Depreciable amount and depreciation period

50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

51 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

52 Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.

53 The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.

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

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

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

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

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

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

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

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

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

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

Depreciation method

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

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

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

Impairment

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

64 [Deleted]

Compensation for impairment

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

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

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

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

(c) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and

(d) the cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Derecognition

67 **The carrying amount of an item of property, plant and equipment shall be derecognised:**

(a) on disposal; or

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

68 **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless HKAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.**

68A However, an entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others shall transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets shall be recognised as revenue in accordance with HKAS 18 *Revenue*. HKFRS 5 does not apply when assets that are held for sale in the ordinary course of business are transferred to inventories.

69 The disposal of an item of property, plant and equipment may occur in a variety of ways (eg by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in HKAS 18 for recognising revenue from the sale of goods. HKAS 17 applies to disposal by a sale and leaseback.

70 If, under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

71 **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.**

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

Disclosure

73 **The financial statements shall disclose, for each class of property, plant and equipment:**

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

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

(i) additions;

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

(iii) acquisitions through business combinations;

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

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

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

(vii) depreciation;

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

(ix) other changes.

74 The financial statements shall also disclose:

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

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

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

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

75 Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:

(a) depreciation, whether recognised in profit or loss or as a part of the cost of other assets, during a period; and

(b) accumulated depreciation at the end of the period.

76 In accordance with HKAS 8 an entity discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:

(a) residual values;

(b) the estimated costs of dismantling, removing or restoring items of property, plant and equipment;

(c) useful lives; and

(d) depreciation methods.

77 If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed in addition to the disclosures required by HKFRS 13:

(a) the effective date of the revaluation;

(b) whether an independent valuer was involved;

(c) [deleted]~~the methods and significant assumptions applied in estimating the items' fair values;~~

(d) [deleted]~~the extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques;~~

(e) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and

(f) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

78 In accordance with HKAS 36 an entity discloses information on impaired property, plant and equipment in addition to the information required by paragraph 73(e)(iv)-(vi).

79 Users of financial statements may also find the following information relevant to their needs:

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

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

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

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

Therefore, entities are encouraged to disclose these amounts.

Transitional provisions

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

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

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

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

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

Effective date

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

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

81A An entity shall apply the amendments in paragraph 3 for annual periods beginning on or after 1 January 2006. If an entity applies HKFRS 6 for an earlier period, those amendments shall be applied for that earlier period.

81B HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 39, 40 and 73(e)(iv). An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

81C HKFRS 3 *Business Combinations* (as revised in 2008) amended paragraph 44. 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.

81D Paragraphs 6 and 69 were amended and paragraph 68A was added 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 and at the same time apply the related amendments to HKAS 7 *Statement of Cash Flows*.

81E Paragraph 5 was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2009. Earlier application is permitted if an entity also applies the amendments to paragraphs 8, 9, 22, 48, 53, 53A, 53B, 54, 57 and 85B of HKAS 40 at the same time. If an entity applies the amendment for an earlier period it shall disclose that fact.

81F HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 6, amended paragraphs 26, 35 and 77 and deleted paragraphs 32 and 33. An entity shall apply those amendments when it applies HKFRS 13.

81G *Annual Improvements 2009-2011 Cycle*, issued in June 2012, amended paragraph 8. 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

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

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

Appendix A

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at 24 November 2005 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 16.

The International Accounting Standard comparable with HKAS 16 is IAS 16 *Property, Plant and Equipment*.

The following sets out the major textual difference between HKAS 16 and IAS 16 and the reason for the difference.

Difference	Reason for the difference
(i) HKAS 16 para 80A A transitional arrangement was introduced in the original SSAP 17 issued in 1995 to relieve certain enterprises which carried their property, plant and equipment at revalued amounts before 30 September 1995 from making regular revaluations.	To carry forward the transitional arrangement previously included in SSAP 17.
(ii) HKAS 16 para 80B A transitional arrangement is included to allow those entities that have previously taken advantage of the exemption under SSAP 17 *Property, Plant and Equipment* to deem the carrying amount of an item of property, plant and equipment immediately before applying this Standard on its effective date (or earlier) as the cost of that item.	To deal with the concern of those exempted entities that it might not be possible for them to trace back the original cost of the asset for applying this Standard.

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.

CONTENTS

from paragraph

BASIS FOR CONCLUSIONS ON IAS 16 *PROPERTY, PLANT AND EQUIPMENT*

Basis for Conclusions on IAS 16 *Property, Plant and Equipment*

This Basis for Conclusions accompanies, but is not part of, IAS 16.

HKAS 16 is based on IAS 16 *Property, Plant and Equipment*. In approving HKAS 16, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 16. Accordingly, there are no significant differences between HKAS 16 and IAS 16. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 16 referred to below generally correspond with those in HKAS 16.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 16 *Property, Plant and Equipment* 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 16. 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 the accounting for property, plant and equipment that was established by IAS 16, this Basis for Conclusions does not discuss requirements in IAS 16 that the Board has not reconsidered.

Scope

BC4 The Board clarified that the requirements of IAS 16 apply to items of property, plant and equipment that an entity uses to develop or maintain (a) biological assets and (b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources. The Board noted that items of property, plant and equipment that an entity uses for these purposes possess the same characteristics as other items of property, plant and equipment.

Recognition

BC5 In considering potential improvements to the previous version of IAS 16, the Board reviewed its subsequent expenditure recognition principle for two reasons. First, the existing subsequent expenditure recognition principle did not align with the asset recognition principle in the *Framework*[*]. Second, the Board noted difficulties in practice in making the distinction it required between expenditures that maintain, and those that enhance, an item of property, plant and equipment. Some expenditures seem to do both.

BC6 The Board ultimately decided that the separate recognition principle for subsequent expenditure was not needed. As a result, an entity will evaluate all its property, plant and equipment costs under IAS 16's general recognition principle. Also, if the cost of a replacement for part of an item of property, plant and equipment is recognised in the carrying amount of an asset, then an entity will derecognise the carrying amount of what was replaced to avoid carrying both the replacement and the replaced portion as assets. This derecognition occurs whether or not what is replaced is a part of an item that the entity depreciates separately.

BC7 The Board's decision on how to handle the recognition principles was not reached easily. In the Exposure Draft (ED), the Board proposed to include within IAS 16's general recognition principle only the recognition of subsequent expenditures that are replacements of a part of an item of property, plant and equipment. Also in the ED, the Board proposed to modify the subsequent expenditure recognition principle to distinguish more clearly the expenditures to which it would continue to apply.

[*] 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*.

BC8 Respondents to the ED agreed that it was appropriate for subsequent expenditures that were replacements of a part of an item of property, plant and equipment that an entity depreciated separately to be covered by the general recognition principle. However, the respondents argued, and the Board agreed, that the modified second principle was not clearer because it would result in an entity recognising in the carrying amount of an asset and then depreciating subsequent expenditures that were for the day-to-day servicing of items of property, plant and equipment, those that might commonly be regarded as for 'repairs and maintenance'. That result was not the Board's intention.

BC9 In its redeliberation of the ED, the Board concluded it could not retain the proposed modified subsequent expenditure recognition principle. It also concluded that it could not revert to the subsequent expenditure principle in the previous version of IAS 16 because, if it did, nothing was improved; the *Framework* conflict was not resolved and the practice issues were not addressed.

BC10 The Board concluded that it was best for all subsequent expenditures to be covered by IAS 16's general recognition principle. This solution had the following advantages:

(a) use of IAS 16's general recognition principle fits the *Framework*.

(b) use of a single recognition principle is a straightforward approach.

(c) retaining IAS 16's general recognition principle and combining it with the derecognition principle will result in financial statements that reflect what is occurring, ie both the flow of property, plant and equipment through an entity and the economics of the acquisition and disposal process.

(d) use of one recognition principle fosters consistency. With two principles, consistency is not achieved unless it is clear when each should apply. Because IAS 16 does not address what constitutes an 'item' of property, plant and equipment, this clarity was not assured because some might characterise a particular cost as the initial cost of a new item of property, plant and equipment and others might regard it as a subsequent cost of an existing item of property, plant and equipment.

BC11 As a consequence of placing all subsequent expenditures under IAS 16's general recognition principle, the Board also included those expenditures under IAS 16's derecognition principle. In the ED, the Board proposed the derecognition of the carrying amount of a part of an item that was depreciated separately and was replaced by a subsequent expenditure that an entity recognised in the carrying amount of the asset under the general recognition principle. With this change, replacements of a part of an item that are not depreciated separately are subject to the same approach.

BC12 The Board noted that some subsequent expenditures on property, plant and equipment, although arguably incurred in the pursuit of future economic benefits, are not sufficiently certain to be recognised in the carrying amount of an asset under the general recognition principle. Thus, the Board decided to state in the Standard that an entity recognises in profit or loss as incurred the costs of the day-to-day servicing of property, plant and equipment.

Classification of servicing equipment

BC12A In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board responded to a request to address a perceived inconsistency in the classification requirements for servicing equipment. Paragraph 8 of IAS 16 was unclear on the classification of servicing equipment as inventory or property, plant and equipment and led some to think that servicing equipment used during more than one period would be classified as part of inventory. The Board decided to clarify that items such as spare parts, stand-by equipment and servicing equipment shall be recognised as property, plant and equipment when they meet the definition of property, plant and equipment. If they do not meet this definition they are classified as inventory. In the light of respondents' comments to the June 2011 exposure draft, the Board did not make explicit reference to the classification of particular types of equipment, because the definition of property, plant and equipment already provides sufficient guidance. The Board also deleted from paragraph 8 the requirement to account for spare parts and servicing equipment as property, plant and equipment only if they were used in connection with an item of property, plant and equipment because this requirement was too restrictive when compared with the definition of property, plant and equipment.

Measurement at recognition

Asset dismantlement, removal and restoration costs

BC13 The previous version of IAS 16 provided that in initially measuring an item of property, plant and equipment at its cost, an entity would include the cost of dismantling and removing that item and restoring the site on which it is located to the extent it had recognised an obligation for that cost. As part of its deliberations, the Board evaluated whether it could improve this guidance by addressing associated issues that have arisen in practice.

BC14 The Board concluded that the relatively limited scope of the Improvements project warranted addressing only one matter. That matter was whether the cost of an item of property, plant and equipment should include the initial estimate of the cost of dismantlement, removal and restoration that an entity incurs as a consequence of using the item (instead of as a consequence of acquiring it). Therefore, the Board did not address how an entity should account for (a) changes in the amount of the initial estimate of a recognised obligation, (b) the effects of accretion of, or changes in interest rates on, a recognised obligation or (c) the cost of obligations an entity did not face when it acquired the item, such as an obligation triggered by a law change enacted after the asset was acquired.

BC15 The Board observed that whether the obligation is incurred upon acquisition of the item or while it is being used, its underlying nature and its association with the asset are the same. Therefore, the Board decided that the cost of an item should include the costs of dismantlement, removal or restoration, the obligation for which an entity has incurred as a consequence of having used the item during a particular period other than to produce inventories during that period. An entity applies IAS 2 *Inventories* to the costs of these obligations that are incurred as a consequence of having used the item during a particular period to produce inventories during that period. The Board observed that accounting for these costs initially in accordance with IAS 2 acknowledges their nature. Furthermore, doing so achieves the same result as including these costs as an element of the cost of an item of property, plant and equipment, depreciating them over the production period just completed and identifying the depreciation charge as a cost to produce another asset (inventory), in which case the depreciation charge constitutes part of the cost of that other asset.

BC16 The Board noted that because IAS 16's initial measurement provisions are not affected by an entity's subsequent decision to carry an item under the cost model or the revaluation model, the Board's decision applies to assets that an entity carries under either treatment.

Asset exchange transactions

BC17 Paragraph 22 of the previous version of IAS 16 indicated that if (a) an item of property, plant and equipment is acquired in exchange for a similar asset that has a similar use in the same line of business and has a similar fair value or (b) an item of property, plant and equipment is sold in exchange for an equity interest in a similar asset, then no gain or loss is recognised on the transaction. The cost of the new asset is the carrying amount of the asset given up (rather than the fair value of the purchase consideration given for the new asset).

BC18 This requirement in the previous version of IAS 16 was consistent with views that:

(a) gains should not be recognised on exchanges of assets unless the exchanges represent the culmination of an earning process;

(b) exchanges of assets of a similar nature and value are not a substantive event warranting the recognition of gains; and

(c) requiring or permitting the recognition of gains from such exchanges enables entities to 'manufacture' gains by attributing inflated values to the assets exchanged, if the assets do not have observable market prices in active markets.

BC19 The approach described above raised issues about how to identify whether assets exchanged are similar in nature and value. The Board reviewed this topic, and noted views that:

(a) under the *Framework*, the recognition of income from an exchange of assets does not depend on whether the assets exchanged are dissimilar;

(b) income is not necessarily earned only at the culmination of an earning process, and in some cases it is arbitrary to determine when an earning process culminates;

(c) generally, under both measurement bases after recognition that are permitted under IAS 16, gain recognition is not deferred beyond the date at which assets are exchanged; and

(d) removing 'existing carrying amount' measurement of property, plant and equipment acquired in exchange for similar assets would increase the consistency of measurement of acquisitions of assets.

BC20 The Board decided to require in IAS 16 that all items of property, plant and equipment acquired in exchange for non-monetary assets or a combination of monetary and non-monetary assets should be measured at fair value, except that, if the exchange transaction lacks commercial substance or the fair value of neither of the assets exchanged can be determined reliably, then the cost of the asset acquired in the exchange should be measured at the carrying amount of the asset given up.

BC21 The Board added the 'commercial substance' test in response to a concern raised in the comments it received on the ED. This concern was that, under the Board's proposal, an entity would measure at fair value an asset acquired in a transaction that did not have commercial substance, ie the transaction did not have a discernible effect on an entity's economics. The Board agreed that requiring an evaluation of commercial substance would help to give users of the financial statements assurance that the substance of a transaction in which the acquired asset is measured at fair value (and often, consequentially, a gain on the disposal of the transferred asset is recognised in income) is the same as its legal form.

BC22 The Board concluded that in evaluating whether a transaction has commercial substance, an entity should calculate the present value of the post-tax cash flows that it can reasonably expect to derive from the portion of its operations affected by the transaction. The discount rate should reflect the entity's current assessment of the time value of money and the risks specific to those operations rather than those that marketplace participants would make.

BC23 The Board included the 'reliable measurement' test for using fair value to measure these exchanges to minimise the risk that entities could 'manufacture' gains by attributing inflated values to the assets exchanged. Taking into consideration its project for the convergence of IFRSs and US GAAP, the Board discussed whether to change the manner in which its 'reliable measurement' test is described. The Board observed this was unnecessary because it believes that its guidance and that contained in US GAAP are intended to have the same meaning.

BC24 The Board decided to retain, in IAS 18 *Revenue,* its prohibition on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board has on its agenda a project on revenue recognition and does not propose to make any significant amendments to IAS 18 until that project is completed.

Measurement after recognition

Revaluation model

BC25 The Board is taking part in research activities with national standard-setters on revaluations of property, plant and equipment. This research is intended to promote international convergence of standards. One of the most important issues is identifying the preferred measurement attribute for revaluations. This research could lead to proposals to amend IAS 16.

Depreciation: unit of measure

BC26 The Board's discussions about the potential improvements to the depreciation principle in the previous version of IAS 16 included consideration of the unit of measure an entity uses to depreciate its items of property, plant and equipment. Of particular concern to the Board were situations in which the unit of measure is the 'item as a whole' even though that item may be composed of significant parts with individually varying useful lives or consumption patterns. The Board did not believe that, in these situations, an entity's use of approximation techniques, such as a weighted average useful life for the item as a whole, resulted in depreciation that faithfully represents an entity's varying expectations for the significant parts.

BC27 The Board sought to improve the previous version of IAS 16 by proposing in the ED revisions to existing guidance on separating an item into its parts and then further clarifying in the Standard the need for an entity to depreciate separately any significant parts of an item of property, plant and equipment. By doing so an entity will also separately depreciate the item's remainder.

Depreciation: depreciable amount

BC28 During its discussion of depreciation principles, the Board noted the concern that, under the cost model, the previous version of IAS 16 does not state clearly why an entity deducts an asset's residual value from its cost to determine the asset's depreciable amount. Some argue that the objective is one of precision, ie reducing the amount of depreciation so that it reflects the item's net cost. Others argue that the objective is one of economics, ie stopping depreciation if, because of inflation or otherwise, an entity expects that during its useful life an asset will increase in value by an amount greater than it will diminish.

BC29 The Board decided to improve the previous version of IAS 16 by making clear the objective of deducting a residual value in determining an asset's depreciable amount. In doing so, the Board did not adopt completely either the 'net cost' or the 'economics' objective. Given the concept of depreciation as a cost allocation technique, the Board concluded that an entity's expectation of increases in an asset's value, because of inflation or otherwise, does not override the need to depreciate it. Thus, the Board changed the definition of residual value to the amount an entity could receive for the asset currently (at the financial reporting date) if the asset were already as old and worn as it will be when the entity expects to dispose of it. Thus, an increase in the expected residual value of an asset because of past events will affect the depreciable amount; expectations of future changes in residual value other than the effects of expected wear and tear will not.

Depreciation: depreciation period

BC30 The Board decided that the useful life of an asset should encompass the entire time it is available for use, regardless of whether during that time it is in use or is idle. Idle periods most commonly occur just after an asset is acquired and just before it is disposed of, the latter while the asset is held either for sale or for another form of disposal.

BC31 The Board concluded that, whether idle or not, it is appropriate to depreciate an asset with a limited useful life so that the financial statements reflect the consumption of the asset's service potential that occurs while the asset is held. The Board also discussed but decided not to address the measurement of assets held for sale. The Board concluded that whether to apply a different measurement model to assets held for sale—which may or may not be idle— was a different question and was beyond the scope of the Improvements project.

BC32 In July 2003 the Board published ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*. ED 4 was published as part of the Board's short-term convergence project, the scope of which was broader than that of the Improvements project. In ED 4, the Board proposed that an entity should classify some of its assets as 'assets held for sale' if specified criteria are met. Among other things, the Board proposed that an entity should cease depreciating an asset classified in this manner, irrespective of whether the asset is idle. The basis for this proposal was that the carrying amount of an asset held for sale will be recovered principally through sale rather than future operations, and therefore accounting for the asset should be a process of valuation rather than allocation. The Board will amend IAS 16 accordingly when ED 4 is finalised.

Depreciation: depreciation method

BC33 The Board considered how an entity should account for a change in a depreciation method. The Board concluded that a change in a depreciation method is a change in the technique used to apply the entity's accounting policy to recognise depreciation as an asset's future economic benefits are consumed. Therefore, it is a change in an accounting estimate.

Derecognition

Derecognition date

BC34 The Board decided that an entity should apply the revenue recognition principle in IAS 18 for sales of goods to its gains from the sales of items of property, plant and equipment. The requirements in that principle ensure the representational faithfulness of an entity's recognised revenue. Representational faithfulness is also the appropriate objective for an entity's recognised gains. However, in IAS 16, the revenue recognition principle's criteria drive derecognition of the asset disposed of rather than recognition of the proceeds received. Applying the principle instead to the recognition of the proceeds might lead to the conclusion that an entity will recognise a deferred gain. Deferred gains do not meet the definition of a liability under the *Framework*. Thus, the Board decided that an entity does not derecognise an item of property, plant and equipment until the requirements in IAS 18 to recognise revenue on the sale of goods are met.

Gain classification

BC35 Although the Board concluded that an entity should apply the recognition principle for revenue from sales of goods to its recognition of gains on disposals of items of property, plant and equipment, the Board concluded that the respective approaches to income statement display should differ. The Board concluded that users of financial statements would consider these gains and the proceeds from an entity's sale of goods in the course of its ordinary activities differently in their evaluation of an entity's past results and their projections of future cash flows. This is because revenue from the sale of goods is typically more likely to recur in comparable amounts than are gains from sales of items of property, plant and equipment. Accordingly, the Board concluded that an entity should not classify as revenue gains on disposals of items of property, plant and equipment.

Assets held for rental to others*

BC35A The Board identified that, in some industries, entities are in the business of renting and subsequently selling the same assets.

BC35B The Board noted that the Standard prohibits classification as revenue of gains arising from derecognition of items of property, plant and equipment. The Board also noted that paragraph BC35 states the reason for this is 'users of financial statements would consider these gains and the proceeds from an entity's sale of goods in the course of its ordinary activities differently in their evaluation of an entity's past results and their projections of future cash flows.'

BC35C Consistently with that reason, the Board concluded that entities whose ordinary activities include renting and subsequently selling the same assets should recognise revenue from both renting and selling the assets. In the Board's view, the presentation of gross selling revenue, rather than a net gain or loss on the sale of the assets, would better reflect the ordinary activities of such entities.

BC35D The Board concluded that the disclosure requirements of IAS 16, IAS 2 and IAS 18 would lead an entity to disclose relevant information for users.

BC35E The Board also concluded that paragraph 14 of IAS 7 *Statement of Cash Flows* should be amended to present within operating activities cash payments to manufacture or acquire such assets and cash receipts from rents and sales of such assets.

* Paragraphs BC35A–BC35F were added as a consequence of amendments to IAS 16 by *Improvements to IFRSs* issued in May 2008. At the same time, the Board also amended paragraph 6 by replacing the term 'net selling price' in the definition of 'recoverable amount' with 'fair value less costs to sell' for consistency with the wording used in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*.

BC35F The Board discussed the comments received in response to its exposure draft of proposed *Improvements to International Financial Reporting Standards* published in 2007 and noted that a few respondents would prefer the issue to be included in one of the Board's major projects such as the revenue recognition project or the financial statement presentation project. However, the Board noted that the proposed amendment would improve financial statement presentation before those projects could be completed and decided to add paragraph 68A as previously exposed. A few respondents raised the concern that the term 'held for sale' in the amendment could be confused with the notion of held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Consequently, the Board clarified in the amendment that IFRS 5 should not be applied in those circumstances.

Transitional provisions

BC36. The Board concluded that it would be impracticable for an entity to determine retrospectively whether a previous transaction involving an exchange of non-monetary assets had commercial substance. This is because it would not be possible for management to avoid using hindsight in making the necessary estimates as of earlier dates. Accordingly, the Board decided that in accordance with the provisions of IAS 8 an entity should consider commercial substance only in evaluating the initial measurement of future transactions involving an exchange of non-monetary assets.

Summary of changes from the Exposure Draft

BC37. The main changes from the ED proposals to the revised Standard are as follows.

(a) The ED contained two recognition principles, one applying to subsequent expenditures on existing items of property, plant and equipment. The Standard contains a single recognition principle that applies to costs incurred initially to acquire an item and costs incurred subsequently to add to, replace part of or service an item. An entity applies the recognition principle to the latter costs at the time it incurs them.

(b) Under the approach proposed in the ED, an entity measured an item of property, plant and equipment acquired in exchange for a non-monetary asset at fair value irrespective of whether the exchange transaction in which it was acquired had commercial substance. Under the Standard, a lack of commercial substance is cause for an entity to measure the acquired asset at the carrying amount of the asset given up.

(c) Compared with the Standard, the ED did not as clearly set out the principle that an entity separately depreciates at least the parts of an item of property, plant and equipment that are of significant cost.

(d) Under the approach proposed in the ED, an entity derecognised the carrying amount of a replaced part of an item of property, plant and equipment if it recognised in the carrying amount of the asset the cost of the replacement under the general recognition principle. In the Standard, an entity also applies this approach to a replacement of a part of an item that is not depreciated separately.

(e) In finalising the Standard, the Board identified further necessary consequential amendments to IFRS 1, IAS 14, IAS 34, IAS 36, IAS 37, IAS 38, IAS 40, SIC-13, SIC-21, SIC-22 and SIC-32.

Table of Concordance

This table shows how the contents of the superseded SSAP 17 and the current HKAS 16 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though their guidance may differ.

The table also shows how the requirements of Interpretation 5 have been incorporated into the current HKAS 16.

Superseded SSAP 17 paragraph	**Current HKAS 16 paragraph**
Introduction	1
1	2
2	None
3	None
4	3
5	4
6	6
7	7
8	None
9	None
10	None
11	None
12	8, 9
13	43-47
14	11
15	15
16	16-18
17	23
18	19, 20
19	22
20	27
21	26
22	None
23	None
24	None

Superseded SSAP 17 paragraph	**Current HKAS 16 paragraph**
25	None
26	None
27	13
28-29	14
30	30
31	31
32	32
33	32, 33
34	34
35	35
36	36
37	37
38	38
39	39
40	40
41	41
42	None
43	48, 50, 60
44	52
45	56
46	57
47	58
48	51, 53
49	62
50	49
51	51

Superseded SSAP 17 paragraph	Current HKAS 16 paragraph
52	None
53	None
54	61
55	63
56	64
57-65	None
66	67
67	68, 71
68	None
69	69
70	55
71	73
72	74
73	75
74	76
75	77
76	78

Superseded SSAP 17 paragraph or Interpretation	Current HKAS 16 paragraph
77	79
78	81
79	82, 83
80	80A
81	None
82	None
Interpretation 5	65, 66
None	5
None	10
None	12
None	21
None	24, 25
None	28
None	29
None	42
None	54
None	59
None	70
None	72
None	80-82

HKAS 17
Revised ~~July 2012~~February 2014

Hong Kong Accounting Standard 17

Leases

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

CONTENTS

Hong Kong Accounting Standard 17 *Leases* (HKAS 17) is set out in paragraphs 1-70 and the Appendix. All the paragraphs have equal authority. HKAS 17 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of Financial Statements~~Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Gross investment in the lease **is the aggregate of:**

(a) the minimum lease payments receivable by the lessor under a finance lease, and

(b) any unguaranteed residual value accruing to the lessor.

Net investment in the lease **is the gross investment in the lease discounted at the interest rate implicit in the lease.**

Unearned finance income **is the difference between:**

(a) the gross investment in the lease, and

(b) the net investment in the lease.

The *interest rate implicit in the lease* **is the discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.**

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

Contingent rent **is that portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (eg percentage of future sales, amount of future use, future price indices, future market rates of interest).**

5 A lease agreement or commitment may include a provision to adjust the lease payments for changes in the construction or acquisition cost of the leased property or for changes in some other measure of cost or value, such as general price levels, or in the lessor's costs of financing the lease, during the period between the inception of the lease and the commencement of the lease term. If so, the effect of any such changes shall be deemed to have taken place at the inception of the lease for the purposes of this Standard.

6 The definition of a lease includes contracts for the hire of an asset that contain a provision giving the hirer an option to acquire title to the asset upon the fulfilment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

6A HKAS 17 uses the term 'fair value' in a way that differs in some respects from the definition of fair value in HKFRS 13 *Fair Value Measurement*. Therefore, when applying HKAS 17 an entity measures fair value in accordance with HKAS 17, not HKFRS 13.

Classification of leases

7 The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

8 A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

9 Because the transaction between a lessor and a lessee is based on a lease agreement between them, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the lessor and lessee may result in the same lease being classified differently by them. For example, this may be the case if the lessor benefits from a residual value guarantee provided by a party unrelated to the lessee.

BC10 The Board noted that an allocation of the minimum lease payments by reference to the relative fair values of the land and buildings would not reflect the fact that land often has an indefinite economic life, and therefore would be expected to maintain its value beyond the lease term. In contrast, the future economic benefits of a building are likely to be used up, at the least to some extent, over the lease term. Therefore, it would be reasonable to expect that the lease payments relating to the building would be set at a level that enabled the lessor not only to make a return on initial investment, but also to recoup the value of the building used up over the term of the lease. In the case of land, the lessor would not normally need compensation for using up the land.

BC11 Therefore, the Board decided to clarify in the Standard that the allocation of the minimum lease payments is weighted to reflect their role in compensating the lessor, and not by reference to the relative fair values of the land and buildings. In other words, the weighting should reflect the lessee's leasehold interest in the land and the buildings. In the extreme case that a building is fully depreciated over the lease term, the minimum lease payments would need to be weighted to provide a return plus the full depreciation of the building's value at the inception of the lease. The leasehold interest in the land would, assuming a residual value that equals its value at the inception of the lease, have a weighting that reflects only a return on the initial investment.

Impracticability of split between land and buildings

BC12 A question that arises is how to treat leases for which it is not possible to measure the two elements reliably (eg because similar land and buildings are not sold or leased separately). One possibility would be to classify the entire lease as a finance lease. This would prevent a lessee from avoiding finance lease treatment for the buildings by asserting that it cannot separately measure the two elements. However, it may be apparent from the circumstances that classifying the entire lease as a finance lease is not representationally faithful. In view of this, the Board decided that when it is not possible to measure the two elements reliably, the entire lease should be classified as a finance lease unless it is clear that both elements should be classified as an operating lease.

Exception to the requirement to separate the land and buildings elements

BC13 The Board discussed whether to allow or require an exception from the requirement to separate the land and buildings elements in cases in which the present value of the land element at the inception of the lease is small in relation to the value of the entire lease. In such cases the benefits of separating the lease into two elements and accounting for each separately may not outweigh the costs. The Board noted that generally accepted accounting principles in Australia, Canada and the United States allow or require such leases to be classified and accounted for as a single unit, with finance lease treatment being used when the relevant criteria are met. The Board decided to allow land and buildings to be treated as a single unit when the land element is immaterial.

BC14 Some respondents to the Exposure Draft requested guidance on how small the relative value of the land element needs to be in relation to the total value of the lease. The Board decided not to introduce a bright line such as a specific percentage threshold. The Board decided that the normal provisions on materiality should apply.

Transitional provisions

BC15 The Board decided that the requirement to separate the land and buildings elements in a lease of land and buildings should be applied retrospectively. It noted that there will be cases when it will be impracticable to reassess the treatment of these leases retrospectively, because doing so requires estimating what the fair value of the two elements was at the inception of the lease, which may have been many years before. The Board also noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* contains guidance on when it is impracticable to apply retrospectively a change in accounting policy and therefore decided not to provide specific transitional provisions for the implementation of this revision to IAS 17.

Inception of the lease and commencement of the lease term

BC16 The previous version of IAS 17 did not define the commencement of the lease term. It implicitly assumed that commencement (when the lease begins) and inception (when the agreement is entered into) are simultaneous. Some respondents questioned what should happen if there is a time lag between the two dates, particularly if the amounts change – for example, because the asset is under construction and the final cost is not known at inception. The Standard now specifies that recognition takes place at commencement, based on values measured at inception. However, if the lease is adjusted for changes in the lessor's costs between the inception of the lease and the commencement of the lease term, the effect of any such changes is deemed to have taken place at inception. These revisions are consistent with generally accepted accounting principles in Australia, Canada and the United States, and are consistent with the present accounting treatment of most ordinary purchases and sales.

BC17 In agreeing on this treatment, the Board noted that measurement at commencement would have been more satisfactory in principle. However, this cannot be done properly within the framework of IAS 17 because the Standard generally requires a finance lease receivable or payable to be recognised at an amount based on the fair value of the asset, which is inappropriate at any date after inception.

Leases in the financial statements of lessors other than manufacturers and dealers

BC18 Lessors may incur direct costs in negotiating a lease, such as commissions, brokers' fees and legal fees. The previous version of IAS 17 contained a choice on how to account for such costs—they might be either charged as an expense as incurred or allocated over the lease term. The choice of treatment applied to operating and finance leases. In the case of a finance lease, paragraph 33 of the previous version of IAS 17 stated that allocation over the lease term might be achieved by recognising the cost as an expense and, in the same period, recognising an equal amount of unearned finance income.

BC19 The Board decided that this treatment was not in accordance with the *Framework for the Preparation and Presentation of Financial Statements.*[*] Its effect was to recognise some future finance income as income and an asset at the commencement of the lease term. However, at that date, the *Framework*'s definitions of income and assets are not met. Therefore the Board decided that if direct costs incurred by lessors are to be allocated over the lease term, this should be achieved by including them in the carrying amount of the lease asset.

BC20 The Board noted that standard-setters in Australia, Canada, France, Japan, the United Kingdom and the United States either permit or require initial direct costs to be allocated over the lease term. The Board also noted that other Standards permit or require the recognition of a range of similar costs in the carrying amount of assets, generally subject to those costs being directly attributable to the acquisition of the asset in question. Hence, for reasons of convergence and comparability with other Standards, the Board decided to require initial direct costs to be included in the carrying amount of the lease asset.

BC21 For consistency with other Standards, in particular IAS 39 *Financial Instruments: Recognition and Measurement*, the Board decided that recognition in the carrying amount of assets should be restricted to costs that are incremental and directly attributable to negotiating and arranging a lease.

[*] 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 20
Revised ~~March 2010~~February 2014

Hong Kong Accounting Standard 20

Accounting for Government Grants and Disclosure of Government Assistance

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CONTENTS

from paragraph

HONG KONG ACCOUNTING STANDARD 20
ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Hong Kong Accounting Standard 20 *Accounting for Governments Grants and Disclosure of Government Assistance* (HKAS 20) is set out in paragraphs 1-~~43~~46. All the paragraphs have equal authority. HKAS 20 should be read in the context of the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Statements* and the *Conceptual Framework for ~~the Preparation and Presentation of Financial Statements~~Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Hong Kong Accounting Standard 20
Accounting for Government Grants and Disclosure of Government Assistance✦

Scope

1 **This Standard shall be applied in accounting for, and in the disclosure of, government grants and in the disclosure of other forms of government assistance.**

2 This Standard does not deal with:

(a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.

(b) government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates.

(c) government participation in the ownership of the entity.

(d) government grants covered by HKAS 41 *Agriculture.*

Definitions

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

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

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

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

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

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

✦ As part of *Improvements to HKFRSs* issued in October 2008 the HKICPA amended terminology used in this Standard to be consistent with other HKFRSs as follows: (a) 'taxable income' was amended to 'taxable profit or tax loss', (b) 'recognised as income/expense' was amended to 'recognised in profit or loss', (c) 'credited directly to shareholders' interests/equity' was amended to 'recognised outside profit or loss', and (d)'revision to an accounting estimate' was amended to 'change in accounting estimate'.

[*] See also HK(SIC)-Int 10 *Government Assistance – No Specific Relation to Operating Activities.*

Forgivable loans **are loans which the lender undertakes to waive repayment of under certain prescribed conditions.**

Fair value **~~is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller 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.*)**

4 Government assistance takes many forms varying both in the nature of the assistance given and in the conditions which are usually attached to it. The purpose of the assistance may be to encourage an entity to embark on a course of action which it would not normally have taken if the assistance was not provided.

5 The receipt of government assistance by an entity may be significant for the preparation of the financial statements for two reasons. Firstly, if resources have been transferred, an appropriate method of accounting for the transfer must be found. Secondly, it is desirable to give an indication of the extent to which the entity has benefited from such assistance during the reporting period. This facilitates comparison of an entity's financial statements with those of prior periods and with those of other entities.

6 Government grants are sometimes called by other names such as subsidies, subventions, or premiums.

Government grants

7 Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

8 A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

9 The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government.

10 A forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

10A The benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with HKAS 39 and the proceeds received. The benefit is accounted for in accordance with this Standard. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.

11 Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

12 Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

13 There are two broad approaches to the accounting for government grants: the capital approach, under which a grant is recognised outside profit or loss, and the income approach, under which a grant is recognised in profit or loss over one or more periods.

14 Those in support of the capital approach argue as follows:

(a) government grants are a financing device and should be dealt with as such in the statement of financial position rather than be recognised in profit or loss to offset the items of expense that they finance. Because no repayment is expected, such grants should be recognised outside profit or loss.

(b) it is inappropriate to recognise government grants in profit or loss, because they are not earned but represent an incentive provided by government without related costs.

15 Arguments in support of the income approach are as follows:

(a) because government grants are receipts from a source other than shareholders, they should not be recognised directly in equity but should be recognised in profit or loss in appropriate periods.

(b) government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate.

(c) because income and other taxes are expenses, it is logical to deal also with government grants, which are an extension of fiscal policies, in profit or loss.

16 It is fundamental to the income approach that government grants should be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate. Recognition of government grants in profit or loss on a receipts basis is not in accordance with the accrual accounting assumption (see HKAS 1 *Presentation of Financial Statements*) and would be acceptable only if no basis existed for allocating a grant to periods other than the one in which it was received.

17 In most cases the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable. Thus grants in recognition of specific expenses are recognised in profit or loss in the same period as the relevant expenses. Similarly, grants related to depreciable assets are usually recognised in profit or loss over the periods and in the proportions in which depreciation expense on those assets is recognised.

18 Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building.

19 Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached. In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another.

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

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

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

Non-monetary government grants

23 A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

Presentation of grants related to assets

24 Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

25 Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to assets are regarded as acceptable alternatives.

26 One method recognises the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

27 The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

28 The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. For this reason and in order to show the gross investment in assets, such movements are often disclosed as separate items in the statement of cash flows regardless of whether or not the grant is deducted from the related asset for presentation purposes in the statement of financial position.

Presentation of grants related to income

29 Grants related to income are ~~sometimes~~ presented as ~~a credit in the statement of comprehensive income~~part of profit or loss, either separately or under a general heading such as "Other income"; alternatively, they are deducted in reporting the related expense.

29A ~~If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), it presents grants related to income as required in paragraph 29 in that separate statement.~~[Deleted]

30 Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method it is argued that the expenses might well not have been incurred by the entity if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.

31 Both methods are regarded as acceptable for the presentation of grants related to income. Disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.

Repayment of government grants

32 **A government grant that becomes repayable shall be accounted for as a change in accounting estimate (see HKAS 8** *Accounting Policies, Changes in Accounting Estimates and Errors***). Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss. Repayment of a grant related to an asset shall be recognised by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant shall be recognised immediately in profit or loss.**

33 Circumstances giving rise to repayment of a grant related to an asset may require consideration to be given to the possible impairment of the new carrying amount of the asset.

Government assistance

34 Excluded from the definition of government grants in paragraph 3 are certain forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

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

36 The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements may not be misleading.

37 [Deleted]

38 In this Standard, government assistance does not include the provision of infrastructure by improvement to the general transport and communication network and the supply of improved facilities such as irrigation or water reticulation which is available on an ongoing indeterminate basis for the benefit of an entire local community.

Disclosure

39 **The following matters shall be disclosed:**

(a) **the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;**

(b) **the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and**

(c) **unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.**

Transitional provisions

40 [Not used]

Effective date

41 **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) 10** *Government Assistance – No Specific Relation to Operating Activities* **at the same time.**

41a This Standard supersedes SSAP 35 *Accounting for Government Grants and Disclosure of Government Assistance* (issued in March 2002).

42 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it added paragraph 29A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

43 Paragraph 37 was deleted and paragraph 10A added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments prospectively to government loans received in 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.

44 *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

45 HKFRS 13, issued in June 2013, amended the definition of fair value in paragraph 3. An entity shall apply that amendment when it applies HKFRS 13.

46 *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1), issued in July 2011, amended paragraph 29 and deleted paragraph 29A. An entity shall apply those amendments when it applies HKAS 1 as amended in July 2011.

Appendix

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at December 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 20.

The International Accounting Standard comparable with HKAS 20 is IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.*

There are no major textual differences between HKAS 20 and IAS 20.

Basis for Conclusions on IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

This Basis for Conclusions accompanies, but is not part of, IAS 20.

HKAS 20 is based on IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. In approving HKAS 20, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 20. Accordingly, there are no significant differences between HKAS 20 and IAS 20. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 20 referred to below generally correspond with those in HKAS 20.

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in amending IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* as part of *Improvements to IFRSs* issued in May 2008.

BC2 IAS 20 was developed by the International Accounting Standards Committee in 1983 and did not include a Basis for Conclusions. This Basis refers to the insertion of paragraphs 10A and 43 and the deletion of paragraph 37. Those changes require government loans with below-market rates of interest to be recognised and measured in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* and the benefit of the reduced interest to be accounted for using IAS 20.

Accounting for loans from government with a below-market rate of interest

BC3 The Board identified an apparent inconsistency between the guidance in IAS 20 and IAS 39. It related to the accounting for loans with a below-market rate of interest received from a government. IAS 20 stated that no interest should be imputed for such a loan, whereas IAS 39 required all loans to be recognised at fair value, thus requiring interest to be imputed to loans with a below-market rate of interest.

BC4 The Board decided to remove this inconsistency. It believed that the imputation of interest provides more relevant information to a user of the financial statements. Accordingly the Board amended IAS 20 to require that loans received from a government that have a below-market rate of interest should be recognised and measured in accordance with IAS 39. The benefit of the government loan is measured at the inception of the loan as the difference between the cash received and the amount at which the loan is initially recognised in the statement of financial position. This benefit is accounted for in accordance with IAS 20.

BC5 Noting that applying IAS 39 to loans retrospectively may require entities to measure the fair value of loans at a past date, the Board decided that the amendment should be applied prospectively to new loans.

HKAS 24 (Revised)
~~Issued November 2009~~Revised February 2014

Effective for annual periods
beginning on or after 1 January 2011

Hong Kong Accounting Standard 24

Related Party Disclosures

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

CONTENTS

Hong Kong Accounting Standard 24 *Related Party Disclosures* (HKAS 24) is set out in paragraphs 1-29 and Appendix A. All of the paragraphs have equal authority. HKAS 24 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of~~ Financial Reporting ~~Statements~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 24 *Related Party Disclosures* (HKAS 24) requires a reporting entity to disclose:

(a) transactions with its related parties; and

(b) relationships between parents and subsidiaries irrespective of whether there have been transactions between those related parties.

IN2 The Hong Kong Institute of Certified Public Accountants (HKICPA) revised HKAS 24 in 2009 by:

(a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition.

(b) providing a partial exemption from the disclosure requirements for government-related entities.

IN3 In making those revisions, the HKICPA did not reconsider the fundamental approach to related party disclosures contained in HKAS 24 (as issued in 2004).

Hong Kong Accounting Standard 24
Related Party Disclosures

Objective

1 The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.

Scope

2 This Standard shall be applied in:

(a) identifying related party relationships and transactions;

(b) identifying outstanding balances, including commitments, between an entity and its related parties;

(c) identifying the circumstances in which disclosure of the items in (a) and (b) is required; and

(d) determining the disclosures to be made about those items.

3 This Standard requires disclosure of related party relationships, transactions and outstanding balances, including commitments, in the consolidated and separate financial statements of a parent~~, venturer~~ or ~~investor~~ investors with joint control of, or significant influence over, an investee presented in accordance with HKFRS 10 *Consolidated Financial Statement* or HKAS 27 *~~Consolidated and~~ Separate Financial Statements*. This Standard also applies to individual financial statements.

4 Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements. Intragroup related party transactions and outstanding balances are eliminated in the preparation of consolidated financial statements of the group.

Purpose of related party disclosures

5 Related party relationships are a normal feature of commerce and business. For example, entities frequently carry on parts of their activities through subsidiaries, joint ventures and associates. In those circumstances, the entity has the ability to affect the financial and operating policies of the investee through the presence of control, joint control or significant influence.

6 A related party relationship could have an effect on the profit or loss and financial position of an entity. Related parties may enter into transactions that unrelated parties would not. For example, an entity that sells goods to its parent at cost might not sell on those terms to another customer. Also, transactions between related parties may not be made at the same amounts as between unrelated parties.

7 The profit or loss and financial position of an entity may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the entity with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same activity as the former trading partner. Alternatively, one party may refrain from acting because of the significant influence of another—for example, a subsidiary may be instructed by its parent not to engage in research and development.

8 For these reasons, knowledge of an entity's transactions, outstanding balances, including commitments, and relationships with related parties may affect assessments of its operations by users of financial statements, including assessments of the risks and opportunities facing the entity.

Definitions

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

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

(a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) has control or joint control ~~over~~ of the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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

Close members of the family of a person **are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:**

(a) that person's children and spouse or domestic partner;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

Compensation **includes all employee benefits (as defined in HKAS 19 *Employee Benefits*) including employee benefits to which HKFRS 2 *Share-based Payment* applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. Compensation includes:**

(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation;

(d) termination benefits; and

(e) share-based payment.

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

~~*Joint control* **is the contractually agreed sharing of control over an economic activity.**~~

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

~~*Significant influence* **is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies. Significant influence may be gained by share ownership, statute or agreement.**~~

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

A *government-related entity* is an entity that is controlled, jointly controlled or significantly influenced by a government.

The terms 'control', 'joint control' and 'significant influence' are defined in HKFRS 10, HKFRS 11 *Joint Arrangements* and HKAS 28 (2011) *Investments in Associates and Joint Ventures* and are used in this Standard with the meanings specified in those HKFRSs.

10 In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.

11 In the context of this Standard, the following are not related parties:

(a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

(b) two joint venturers simply because they share joint control ~~over~~ of a joint venture.

(c) (i) providers of finance,

(ii) trade unions,

(iii) public utilities, and

(iv) departments and agencies of a government that does not control, jointly control or significant influence the reporting entity,

simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).

(d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

12 In the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture. Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other.

Disclosures

All entities

13 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

14 To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship when control exists, irrespective of whether there have been transactions between the related parties.

15 The requirement to disclose related party relationships between a parent and its subsidiaries is in addition to the disclosure requirements in HKAS 27~~, HKAS 28 *Investments in Associates* and HKAS 31 *Interests in Joint Ventures*~~ and HKFRS 12 *Disclosure of Interests in Other Entities*.

16 Paragraph 13 refers to the next most senior parent. This is the first parent in the group above the immediate parent that produces consolidated financial statements available for public use.

17 An entity shall disclose key management personnel compensation in total and for each of the following categories:

(a) short-term employee benefits;

(b) post-employment benefits;

(c) other long-term benefits;

(d) termination benefits; and

(e) share-based payment.

18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:

(a) the amount of the transactions;

(b) the amount of outstanding balances, including commitments, and:

(i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

(ii) details of any guarantees given or received;

(c) provisions for doubtful debts related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

19 The disclosures required by paragraph 18 shall be made separately for each of the following categories:

(a) the parent;

(b) entities with joint control of, or significant influence over, the entity;

(c) subsidiaries;

(d) associates;

(e) joint ventures in which the entity is a joint venturer;

(f) key management personnel of the entity or its parent; and

(g) other related parties.

20 The classification of amounts payable to, and receivable from, related parties in the different categories as required in paragraph 19 is an extension of the disclosure requirement in HKAS 1 *Presentation of Financial Statements* for information to be presented either in the statement of financial position or in the notes. The categories are extended to provide a more comprehensive analysis of related party balances and apply to related party transactions.

21 The following are examples of transactions that are disclosed if they are with a related party:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other assets;

(c) rendering or receiving of services;

(d) leases;

(e) transfers of research and development;

(f) transfers under licence agreements;

(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);

(h) provision of guarantees or collateral;

(i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts* (recognised and unrecognised); and

(j) settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

22 Participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties (see paragraph ~~34B~~ 42 of HKAS 19 (as amended in 2011)).

23 Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

24 Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Government-related entities

25 A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and outstanding balances, including commitments, with:

(a) a government that has control~~,~~ or joint control of, or significant influence over, the reporting entity; and

(b) another entity that is a related party because the same government has control~~,~~ or joint control of, or significant influence over, both the reporting entity and the other entity.

26 If a reporting entity applies the exemption in paragraph 25, it shall disclose the following about the transactions and related outstanding balances referred to in paragraph 25:

(a) the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);

(b) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

(i) the nature and amount of each individually significant transaction; and

(ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 21.

27 In using its judgement to determine the level of detail to be disclosed in accordance with the requirements in paragraph 26(b), the reporting entity shall consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction such as whether it is:

(a) significant in terms of size;

* HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines executory contracts as contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

(b) carried out on non-market terms;

(c) outside normal day-to-day business operations, such as the purchase and sale of businesses;

(d) disclosed to regulatory or supervisory authorities;

(e) reported to senior management;

(f) subject to shareholder approval.

Effective date and transition

28 An entity shall apply this Standard retrospectively for annual periods beginning on or after 1 January 2011. Earlier application is permitted, either of the whole Standard or of the partial exemption in paragraphs 25-27 for government-related entities. If an entity applies either the whole Standard or that partial exemption for a period beginning before 1 January 2011, it shall disclose that fact.

28A HKFRS 10, HKFRS 11 *Joint Arrangements* and HKFRS 12, issued in June 2011, amended paragraphs 3, 9, 11(b), 15, 19(b) and (e) and 25. An entity shall apply those amendments when it applies HKFRS 10, HKFRS 11 and HKFRS 12.

Withdrawal of HKAS 24 (2004)

29 This Standard supersedes HKAS 24 *Related Party Disclosures* (as issued in 2004).

Appendix A
Amendment to HKFRS 8 *Operating Segments*

The amendments in this appendix shall be applied for annual reporting periods beginning on or after 1 January 2011. If an entity applies this HKFRS for an earlier period, these amendments shall be applied for that earlier period. In amended paragraphs, deleted text is struck through and new text is underlined.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

Appendix B
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in November 2009 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 24 (Revised).

The International Financial Reporting Standard comparable with HKAS 24 (Revised) is IAS 24 *Related Party Disclosures*.

There are no major textual differences between HKAS 24 (Revised) and IAS 24.

Basis for Conclusions on IAS 24 *Related Party Disclosures*

This Basis for Conclusions accompanies, but is not part of, IAS 24.

HKAS 24 (Revised) is based on IAS 24 (Revised) *Related Party Disclosures.* In approving HKAS 24 (Revised), the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 24. Accordingly, there are no significant differences between HKAS 24 (Revised) and IAS 24. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 24 referred to below generally correspond with those in HKAS 24 (Revised).

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 24 *Related Party Disclosures* in 2003 and 2009. 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 24. 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 existing 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* (the 2002 ED), with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the exposure draft. After reviewing the responses, the Board issued a revised version of IAS 24 in December 2003.

BC3 In February 2007 the Board published an exposure draft *State-controlled Entities and the Definition of a Related Party* (the 2007 ED), proposing:

(a) an exemption from the disclosure requirements in IAS 24 for transactions between entities that are controlled, jointly controlled or significantly influenced by a state ('state-controlled entities'[1]); and

(b) amendments to the definition of a related party.

BC4 The Board received 72 comment letters on the 2007 ED. After considering those comments, in December 2008 the Board published revised proposals in an exposure draft *Relationships with the State* (the 2008 ED). The 2008 ED:

(a) presented revised proposals for state-controlled entities; and

(b) proposed one further amendment to the definition of a related party.

BC5 The Board received 75 comment letters on the 2008 ED. After reviewing the responses, the Board issued a revised version of IAS 24 in November 2009.

BC6 Because the Board's intention was not to reconsider the fundamental approach to related party disclosures established by IAS 24, this Basis for Conclusions discusses only the following requirements in IAS 24:

(a) management compensation (paragraphs BC7–BC10);

(b) related party disclosures in separate financial statements (paragraphs BC11–BC17);

1 In finalising the revised version of IAS 24 in 2009, the Board replaced the term 'state' with 'government'.

(c) definition of a related party (paragraphs BC18–BC32);

(d) government-related entities (paragraphs BC33–BC48); and

(e) other minor changes made in 2009 (paragraph BC49).

Management compensation

BC7 The version of IAS 24 issued by the Board's predecessor in 1984 had no exemption for the disclosure of key management personnel compensation. In developing the 2002 ED, the Board proposed that the disclosure of management compensation, expense allowances and similar items paid in the ordinary course of business should not be required because:

(a) the approval processes for key management personnel compensation in some jurisdictions remove the rationale for related party disclosures;

(b) privacy issues arise in some jurisdictions where accountability mechanisms other than disclosure in financial statements exist; and

(c) requiring these disclosures placed weight on the determination of 'key management personnel' and 'compensation', which was likely to prove contentious. In addition, comparability of these disclosures would be unlikely until measurement requirements are developed for all forms of compensation.

BC8 However, some respondents to the 2002 ED objected to the proposed exemption because they were concerned that information relating to management compensation is relevant to users' information needs and that an exemption based on 'items paid in the ordinary course of business' could lead to abuse. Establishing a disclosure exemption on such a criterion without a definition of the terms could lead to exempting other transactions with management from being disclosed, because they could all be structured as 'compensation paid in the ordinary course of an entity's operations'. Respondents argued that such an exemption could lead to abuse because it could potentially apply to any transactions with management.

BC9 The Board was persuaded by the respondents' views on the 2002 ED and decided that the Standard should require disclosure of key management personnel compensation because:

(a) the principle underpinning the requirements in IAS 24 is that transactions with related parties should be disclosed, and key management personnel are related parties of an entity.

(b) key management personnel compensation is relevant to decisions made by users of financial statements when it represents a material amount. The structure and amount of compensation are major drivers in the implementation of the business strategy.

(c) the benefit of this information to users of financial statements largely outweighs the potential lack of comparability arising from the absence of recognition and measurement requirements for all forms of compensation.

BC10 The Board believes that although some jurisdictions have processes for approving compensation for key management personnel in an attempt to ensure an arm's length result, it is clear that some jurisdictions do not. Furthermore, although approval processes for management compensation may involve other parties such as shareholders or investors, key management personnel may still have a significant input. In addition, the Board noted that disclosing key management personnel compensation would improve transparency and comparability, thereby enabling users of financial statements to make a better assessment of the impact of such compensation on the entity's financial position and profit or loss. The Board also noted that the definition of key management personnel and the guidance on compensation in IAS 19 *Employee Benefits* are sufficient to enable entities to disclose the relevant information.

Related party disclosures in separate financial statements

BC11 The version of IAS 24 issued by the Board's predecessor in 1984 exempted disclosures about related party transactions in:

(a) parents' financial statements when they are made available or published with the consolidated statements; and

(b) financial statements of a wholly-owned subsidiary if its parent is incorporated in the same country and provides consolidated financial statements in that country.

BC12 In the 2002 ED the Board proposed to continue exempting separate financial statements of parents and financial statements of wholly-owned subsidiaries from disclosures about any related parties in specified circumstances. It proposed that disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or the financial statements of a wholly-owned subsidiary would not be required, but only if those statements were made available or published with consolidated financial statements for the group.

BC13 The Board proposed to retain this exemption so that entities that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards (IFRSs) in addition to the group's consolidated financial statements would not be unduly burdened. The Board noted that in some circumstances, users can find sufficient information for their purposes regarding a subsidiary from either its financial statements or the group's consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can obtain access to, more information. The Board also noted that users should be aware that amounts recognised in the financial statements of a wholly-owned subsidiary can be affected significantly by the subsidiary's relationship with its parent.

BC14 However, respondents to the 2002 ED objected to this exemption, on the grounds that disclosure of related party transactions and outstanding balances is essential information for external users, who need to be aware of the level of support provided by related parties. The respondents also argued that financial statements prepared in accordance with IFRSs could be presented on a stand-alone basis. Therefore, financial statements prepared on the basis of this proposed exemption would not achieve a fair presentation without related party disclosures.

BC15 The Board was persuaded by those arguments and decided to require the disclosure of related party transactions and outstanding balances in separate financial statements of a parent, investor or venturer in addition to the disclosure requirements in IAS 27 *Consolidated and Separate Financial Statements*,[2] IAS 28 *Investments in Associates*[3] and IAS 31 *Interests in Joint Ventures*.[4]

BC16 The Board noted that the financial statements of an entity that is part of a consolidated group may include the effects of extensive intragroup transactions. Indeed, potentially all of the revenues and expenses for such an entity may derive from related party transactions. The Board concluded that the disclosures required by IAS 24 are essential to understanding the financial position and financial performance of such an entity and therefore should be required for separate financial statements presented in accordance with IAS 27.

BC17 The Board also believed that disclosure of such transactions is essential because the external users need to be aware of the interrelationships between related parties, including the level of support provided by related parties, to assist external users in their economic decisions.

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[2] 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 separate financial statements were not changed.

[3] In May 2011, the Board amended IAS 28 and changed its title to *Investments in Associates and Joint Ventures*.

[4] IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31.

Definition of a related party

BC18 The definition of a related party in IAS 24 was widely considered to be too complex and difficult to apply in practice. The Board noted that the existing definition of a related party had weaknesses: it was cumbersome and included several cross-references that made it difficult to read (and to translate). Therefore, the 2007 and 2008 EDs proposed revised definitions.

BC19 In revising the definition, the Board adopted the following approach:

(a) When an entity assesses whether two parties are related, it would treat significant influence as equivalent to the relationship that exists between an entity and a member of its key management personnel. However, those relationships are not as close as a relationship of control or joint control.

(b) If two entities are both subject to control (or joint control) by the same entity or person, the two entities are related to each other.

(c) If one entity (or person) controls (or jointly controls) a second entity and the first entity (or person) has significant influence over a third entity, the second and third entities are related to each other.

(d) Conversely, if two entities are both subject to significant influence by the same entity (or person), the two entities are not related to each other.

(e) If the revised definition treats one party as related to a second party, the definition should also treat the second party as related to the first party, by symmetry.

BC20 The new definition was not intended to change the meaning of a related party except in the three respects detailed in paragraphs BC21–BC26. The 2008 ED proposed other amendments to the definition for one additional case that had been inadvertently omitted from the 2007 ED and the elimination of further inconsistencies (paragraphs BC27–BC29). In finalising the amendments in 2009, the Board also removed the term ‘significant voting power’ from the definition of a related party (paragraphs BC30 and BC31).

An associate of a subsidiary’s controlling investor

BC21 First, the Board considered the relationship between an associate and a subsidiary of an investor that has significant influence over the associate. The Board observed that when an associate prepares individual or separate financial statements, its investor is a related party. If the investor has a subsidiary, that subsidiary is also related to the associate, because the subsidiary is part of the group that has significant influence over the associate. Although the definition in the 2003 version of IAS 24 incorporated such relationships, the Board concluded that the revised definition should state this more clearly.

BC22 In contrast, when a subsidiary prepares individual or separate financial statements, an associate of the subsidiary’s controlling investor was not a related party as defined in the 2003 version of IAS 24. The subsidiary does not have significant influence over the associate, nor is it significantly influenced by the associate.

BC23 However, the Board decided that, for the same reasons that the parties described in paragraph BC21 are related, the parties described in paragraph BC22 are also related. Thus, the Board amended the definition of a related party to include the relationship discussed in paragraph BC22.

BC24 Furthermore, the Board decided that in the situations described in paragraphs BC21 and BC22, if the investor is a person who has significant influence over one entity and control or joint control over another entity, sufficient influence exists to warrant concluding that the two entities are related.

Two associates of a person

BC25 Secondly, the Board considered the relationship between associates of the investor. IAS 24 does not define associates as related to each other if the investor is an entity. This is because there is insufficient influence through the common investment in two associates. However, the Board noted a discrepancy in that if a person significantly influences one entity and a close member of that person's family significantly influences another entity, those entities were treated as related parties of each other. The Board amended the definition to exclude the entities described in the latter scenario, thereby ensuring a consistent treatment of associates.

Investments of members of key management personnel

BC26 Thirdly, IAS 24 treats some investees of the key management personnel of a reporting entity as related to that entity. However, the definition in the 2003 version of IAS 24 did not include the reciprocal of this—ie for the financial statements of the investee, the other entity managed by the key management personnel was not a related party. To eliminate this inconsistency, the Board amended the definition so that for both sets of financial statements the entities are related parties.

Joint control

BC27 Respondents to the 2007 ED pointed out that one case had been excluded from the restructured definition without being explicitly stated as a change to IAS 24. When a person has joint control over a reporting entity and a close member of that person's family has joint control or significant influence over the other entity, the 2003 version of IAS 24 defined the other entity as related to the reporting entity.

BC28 The Board noted that joint control is generally regarded as influence that is stronger than significant influence. Therefore, the Board concluded that the relationship described in paragraph BC27 should continue to be treated as a related party relationship.

BC29 The definition in the 2003 version of IAS 24 did not include the reciprocal of the case described in paragraph BC27, nor did it deal with cases when a person or a third entity has joint control or significant influence over the two entities. The definition proposed in the 2007 ED would not have rectified these omissions. The Board decided to include these cases in the definition, to treat similar relationships in a consistent manner. In summary, whenever a person or entity has both joint control over a second entity and joint control or significant influence over a third entity, the amendments described in this paragraph and paragraph BC27 treat the second and third entities as related to each other.

Removal of 'significant voting power'

BC30 Respondents to the 2007 and 2008 EDs raised concerns about the term 'significant voting power' in the definition of a related party. They identified anomalies in its use such as when significant voting power created a related party relationship only when that power is held by individuals, not when that power is held by an entity. A further anomaly arose because two entities were classified as related to each other when a third person was a member of the key management personnel of one and had significant voting power in the other; however, they were not treated as related when a third person had significant voting power in both entities.

BC31 In response to these comments, the Board deleted the reference to 'significant voting power' because it was undefined, used inconsistently and created unnecessary complexity. The Board concluded that if the effect of 'significant voting power' was considered to be the same as 'significant influence', its deletion would have no effect because 'significant influence' is in the definition. On the other hand, if the effect of 'significant voting power' was considered to be different from that of 'significant influence', IAS 24 did not explain what that difference was.

Other minor changes to the definition of a related party

BC32 The revisions to IAS 24 in 2009 included the following other minor changes:

(a) The definition of a **related party** is amended:

(i) to replace references to ‘individual’ with ‘person’;

(ii) to clarify that an associate includes subsidiaries of an associate and a joint venture includes subsidiaries of the joint venture; and

(iii) to clarify that two entities are not related parties simply because a member of key management personnel of one entity has significant influence over the other entity.

(b) The definition of a **close member of the family** is amended:

(i) to replace references to ‘individual’ with ‘person’; and

(ii) to delete ‘may’ from the list of examples to state that close members of a person’s family include (rather than ‘may include’) that person’s spouse or domestic partner and children.

Government-related entities

Exemption (paragraph 25)

BC33 The version of IAS 24 that preceded its revision in 2003 did not require ‘state-controlled’ entities to disclose transactions with other such entities. The revised version of IAS 24 issued in 2003 omitted this exemption because at the time the Board concluded that the disclosure requirements would not be a burden for those entities.

BC34 Subsequently concerns were raised that in environments where government control is pervasive, compliance with IAS 24 was problematic. To address those concerns, the 2007 ED proposed an exemption from the disclosure requirements now in paragraph 18 of IAS 24 for government-related entities. In developing that proposal, the Board noted the following:

(a) It can be difficult to identify other government-related entities, particularly in jurisdictions with a large number of such entities. Such entities might not even be aware that an entity with which they have transactions is a related party.

(b) For these transactions, the cost of meeting the requirements in IAS 24 was not always offset by the benefit of increased information for users of financial statements. More specifically:

(i) extensive disclosures were required for transactions that are unaffected by the relationship;

(ii) if some entities are not aware that their transactions are with other government-related entities, the disclosures provided would be incomplete; and

(iii) transactions that are affected by the relationship might well be obscured by excessive disclosures about unaffected transactions.

(c) Some governments establish subsidiaries, joint ventures and associates to compete with each other. In this case, transactions between such entities are likely to be conducted as if they are unrelated parties.

BC35 Respondents to the 2007 ED generally supported an exemption for government-related entities. However, they expressed concerns about the complexity of the specific proposal and asked the Board to clarify various aspects of it. After considering all comments received, the Board proposed a revised exemption for those entities in the 2008 ED.

BC36 Respondents to the 2008 ED generally supported the revised proposal, but some argued that the exemption should not apply to transactions:

(a) between members of a group that is controlled by a government (paragraph BC37); and

(b) between government-related entities that are related for a reason in addition to their relationship with the same government (paragraph BC38).

BC37 Some respondents reasoned that the exemption should not apply to transactions between members of a group that is controlled by a government, for example between a government-related entity and its parent or its fellow subsidiaries. Those respondents noted that the relationship within such a group might sometimes be closer and more influential than between government-related entities in an environment where government control is pervasive. However, for the following reasons the Board concluded that the exemption should also apply within such groups:

(a) Sometimes, requiring disclosure in such cases would negate the purpose of the exemption and could lead to significant differences in the level of disclosure when the substance of the relationships and transactions could be very similar. For example, suppose one government controls all entities directly but another government has similar entities and controls them all through a single holding company. The entities controlled by the first government would all qualify for the exemption but those controlled by the second government would not.

(b) Requiring disclosure in such cases would place considerable pressure on the definition of the boundary between government and entities controlled by the government. For example, suppose a government controls entities through an intermediate institution. It would be necessary to determine whether that institution is an entity controlled by the government (in which case the exemption would not apply) or part of the government (in which case the exemption would apply). This may be answered easily if the institution is a company incorporated under normal company law that simply happens to have the government as a controlling shareholder. It may be less clear if the institution is, for example, a government agency or department.

BC38 The Board identified only one case when government-related entities might be related to each other for reasons other than their relationships with the same government: a government might control both a post-employment benefit plan and the sponsoring employer. However, the main transactions between such a plan and the sponsoring employer are (a) employer contributions and (b) investments by the plan in the employer or in assets used by the employer. IAS 19 already requires a sponsoring employer to disclose most, if not all, of the information that IAS 24 would require if the exemption did not apply. Thus the Board concluded that no significant loss of disclosure would arise from applying the exemption in these cases.

BC39 Paragraph BC34 explains why the Board provided an exemption from the disclosure requirements in paragraph 18 of IAS 24 for government-related entities. It was beyond the scope of the project to consider whether similar exemptions would be appropriate in other circumstances.

BC40 Some respondents to the 2008 ED noted that many financial institutions had recently become government-related entities when governments took significant and sometimes controlling equity interests in them during the global financial crisis. They queried whether the exemption was appropriate in such cases. In finalising the amendments in 2009, the Board identified no reason to treat such entities differently from other government-related entities. The Board noted that in addition to the disclosure requirements in IAS 24, IAS 20 *Accounting for Government Grants and*

Disclosure of Government Assistance requires the reporting entity to disclose information about the receipt of government grants or assistance.

BC41 Respondents to the 2008 ED noted that the proposed definition of 'state' was similar to the definition of 'government' in IAS 20. To avoid confusion and provide consistency, the Board adopted the latter definition when finalising the amendments to IAS 24 in 2009. The Board decided that it need not provide a more comprehensive definition or additional guidance on how to determine what is meant by 'government'. In the Board's view, a more detailed definition could not capture every conceivable government structure across every jurisdiction. In addition, judgement is required by the reporting entity when applying the definition because every jurisdiction has its own way of organising government-related activities.

Disclosure requirements when the exemption applies (paragraph 26)

BC42 The Board considered whether the disclosure requirements in paragraph 26:

(a) met the objective of IAS 24 (paragraphs BC43–BC46); and

(b) were operational (paragraphs BC47 and BC48).

BC43 The objective of IAS 24 is to provide 'disclosures necessary to draw attention to the possibility that [the entity's] financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties'. To meet that objective, paragraph 26 requires some disclosure when the exemption applies. Those disclosures are intended to put users on notice that related party transactions have occurred and to give an indication of their extent. The Board did not intend to require the reporting entity to identify **every** government-related entity, or to quantify in detail **every** transaction with such entities, because such a requirement would negate the exemption.

BC44 Some respondents to the 2008 ED were concerned that qualitative disclosure of individually significant related party transactions alone would not meet the objective of IAS 24 and that combining individually significant transactions with collectively significant transactions would not provide sufficient transparency. The Board concluded that it should require an entity to disclose:

(a) the nature and amount of each individually significant transaction; and

(b) quantitative or qualitative information about other types of transactions that are collectively, but not individually, significant.

BC45 The Board noted that this requirement should not be too onerous for the reporting entity because:

(a) individually significant transactions should be a small subset, by number, of total related party transactions;

(b) the reporting entity should know what those transactions are; and

(c) reporting such items on an exceptional basis takes into account cost-benefit considerations.

BC46 The Board also noted that more disclosure of individually significant transactions would better meet the objective of IAS 24 because this approach focuses on transactions that, through their nature or size, are of more interest to users and are more likely to be affected by the related party relationship.

BC47 Some respondents raised concerns about whether the reporting entity would be able to identify whether the counterparty to individually significant or collectively significant transactions is a related party because it is controlled, jointly controlled or significantly influenced by the same government. The problem of identifying all such counterparties was one of the primary reasons for the exemption.

BC48 However, as discussed in paragraph BC43, it was not the Board's intention to require the reporting entity to identify every government–related entity, or to quantify every transaction with such entities. Moreover, individually significant transactions are likely to attract more scrutiny by management. The Board concluded that management will know, or will apply more effort in establishing, who the counterparty to an individually significant transaction is and will have, or be able to obtain, background information on the counterparty.

Other minor changes made in 2009

BC49 The revisions to IAS 24 in 2009 included the following other changes:

(a) The list of examples of **related party transactions** is amended to include in paragraph 21(i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts. The Board concluded that commitments were one type of transaction, but to avoid doubt decided to make explicit reference to them.

(b) Paragraph 3 relating to the **scope** of IAS 24 is amended to clarify that the Standard applies to individual, as well as separate and consolidated, financial statements because individual financial statements relate to something different from the defined term in IAS 27.[5]

(c) Paragraph 34 of IFRS 8 *Operating Segments* is amended. The Board recognised that in applying the requirements in IFRS 8 it may not be practicable or meaningful to regard all government-related entities as a single customer, especially for environments in which government control is pervasive.

(d) A consequential amendment to the Basis for Conclusions on IAS 19 draws attention to the new definition of a related party. The definition of a qualifying insurance policy in IAS 19 refers to this definition.

[5] 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 definition of separate financial statements was not changed.

Appendix
Amendments to the Basis for Conclusions on IAS 19 *Employee Benefits*

This appendix contains amendments to the Basis for Conclusions on other IFRSs accompanying the equivalent converged IFRSs that are necessary in order to ensure consistency with IAS 24 (as revised in 2009) and the related amendments to other IFRSs. 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 text of the relevant Basis for Conclusions.

Dissenting opinion on IAS 24

Dissent of Robert P Garnett

DO1 Mr Garnett disagrees with the Board's decision to exempt only government-related entities from the requirements of paragraph 18 to disclose information about all transactions with related parties. He also disagrees with the decision not to require all entities to provide information about each individually significant transaction with a related party as set out in paragraph 26(b)(i).

DO2 The Basis for Conclusions sets out clearly the need to remove the unnecessary burden of collecting data for all transactions, entered into and priced on normal business terms, because the counterparty was identified as a related party. It also explains the need to inform investors of individually significant transactions with related parties. Mr Garnett agrees with the explanations in paragraphs BC33–BC48.

DO3 Paragraph 25, however, restricts these changes to entities that are controlled, jointly controlled or significantly influenced by the same government. Mr Garnett sees no reason to make such a distinction, other than to provide limited relief to certain entities.

Illustrative examples

The following examples accompany, but are not part of, IAS 24 Related Party Disclosures. *They illustrate:*

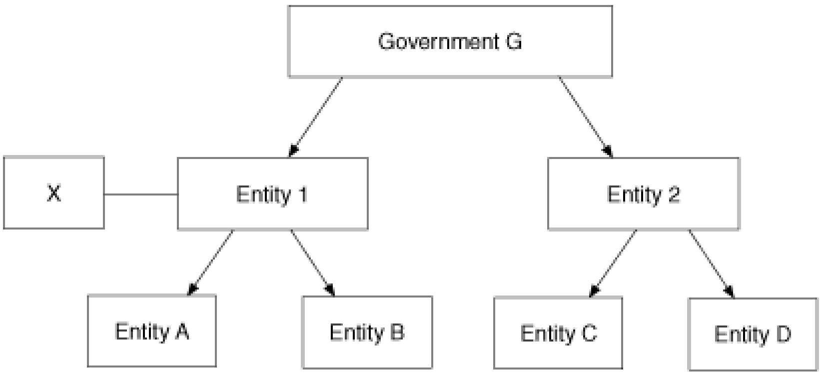
- *the partial exemption for government-related entities; and*
- *how the definition of a related party would apply in specified circumstances.*

In the examples, references to 'financial statements' relate to the individual, separate or consolidated financial statements.

Partial exemption for government-related entities

Example 1 – Exemption from disclosure (paragraph 25)

IE1 Government G directly or indirectly controls Entities 1 and 2 and Entities A, B, C and D. Person X is a member of the key management personnel of Entity 1.



IE2 For Entity A's financial statements, the exemption in paragraph 25 applies to:

(a) transactions with Government G; and

(b) transactions with Entities 1 and 2 and Entities B, C and D.

However, that exemption does not apply to transactions with Person X.

Disclosure requirements when exemption applies (paragraph 26)

IE3 In Entity A's financial statements, an example of disclosure to comply with paragraph 26(b)(i) for **individually** significant transactions could be:

Example of disclosure for individually significant transaction carried out on ***non-market terms***

On 15 January 20X1 Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, sold a 10 hectare piece of land to another government-related utility company for CU5 million.* On 31 December 20X0 a plot of land in a similar location, of a similar size and with similar characteristics, was sold for CU3 million. There had not been any appreciation or depreciation of the land in the intervening period. See note X [of the financial statements] for disclosure of government assistance as required by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and notes Y and Z [of the financial statements] for compliance with other relevant IFRSs.

* In these examples monetary amounts are denominated in 'currency units (CU)'.

*Example of disclosure for individually significant transaction because of **size** of transaction*

In the year ended December 20X1 Government G provided Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, with a loan equivalent to 50 per cent of its funding requirement, repayable in quarterly instalments over the next five years. Interest is charged on the loan at a rate of 3 per cent, which is comparable to that charged on Entity A's bank loans.* See notes Y and Z [of the financial statements] for compliance with other relevant IFRSs.

Example of disclosure of collectively significant transactions

In Entity A's financial statements, an example of disclosure to comply with paragraph 26(b)(ii) for **collectively** significant transactions could be:

Government G, indirectly, owns 75 per cent of Entity A's outstanding shares. Entity A's significant transactions with Government G and other entities controlled, jointly controlled or significantly influenced by Government G are [a large portion of its sales of goods and purchases of raw materials] or [about 50 per cent of its sales of goods and about 35 per cent of its purchases of raw materials].

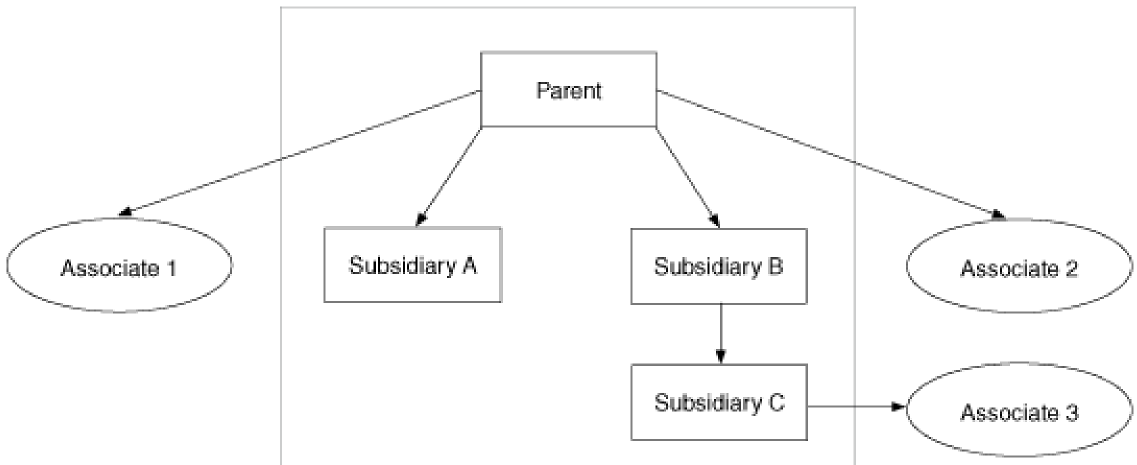
The company also benefits from guarantees by Government G of the company's bank borrowing. See note X [of the financial statements] for disclosure of government assistance as required by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and notes Y and Z [of the financial statements] for compliance with other relevant IFRSs.

Definition of a related party

*The references are to subparagraphs of the definition of a **related party** in paragraph 9 of IAS 24.*

Example 2 – Associates and subsidiaries

IE4 Parent entity has a controlling interest in Subsidiaries A, B and C and has significant influence over Associates 1 and 2. Subsidiary C has significant influence over Associate 3.



* If the reporting entity had concluded that this transaction constituted government assistance it would have needed to consider the disclosure requirements in IAS 20.

IE5 For Parent's separate financial statements, Subsidiaries A, B and C and Associates 1, 2 and 3 are related parties. [*Paragraph 9(b)(i) and (ii)*]

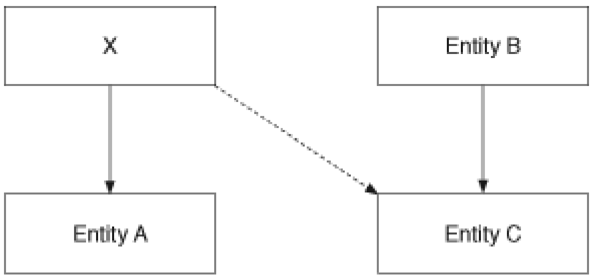
IE6 For Subsidiary A's financial statements, Parent, Subsidiaries B and C and Associates 1, 2 and 3 are related parties. For Subsidiary B's separate financial statements, Parent, Subsidiaries A and C and Associates 1, 2 and 3 are related parties. For Subsidiary C's financial statements, Parent, Subsidiaries A and B and Associates 1, 2 and 3 are related parties. [*Paragraph 9(b)(i) and (ii)*]

IE7 For the financial statements of Associates 1, 2 and 3, Parent and Subsidiaries A, B and C are related parties. Associates 1, 2 and 3 are not related to each other. [*Paragraph 9(b)(ii)*]

IE8 For Parent's consolidated financial statements, Associates 1, 2 and 3 are related to the Group. [*Paragraph 9(b)(ii)*]

Example 3 – Key management personnel

IE9 A person, X, has a 100 per cent investment in Entity A and is a member of the key management personnel of Entity C. Entity B has a 100 per cent investment in Entity C.



IE10 For Entity C's financial statements, Entity A is related to Entity C because X controls Entity A and is a member of the key management personnel of Entity C. [*Paragraph 9(b)(vi)–(a)(iii)*]

IE11 For Entity C's financial statements, Entity A is also related to Entity C if X is a member of the key management personnel of Entity B and not of Entity C. [*Paragraph 9(b)(vi)–(a)(iii)*]

IE12 Furthermore, the outcome described in paragraphs IE10 and IE11 will be the same if X has joint control over Entity A. [*Paragraph 9(b)(vi)–(a)(iii)*] (If X had only significant influence over Entity A and not control or joint control, then Entities A and C would not be related to each other.)

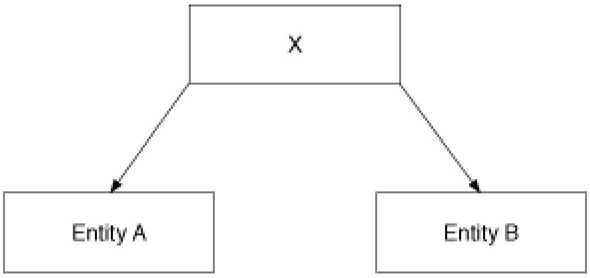
IE13 For Entity A's financial statements, Entity C is related to Entity A because X controls A and is a member of Entity C's key management personnel. [*Paragraph 9(b)(vii)–(a)(i)*]

IE14 Furthermore, the outcome described in paragraph IE13 will be the same if X has joint control over Entity A. The outcome will also be the same if X is a member of key management personnel of Entity B and not of Entity C. [*Paragraph 9(b)(vii)–(a)(i)*]

IE15 For Entity B's consolidated financial statements, Entity A is a related party of the Group if X is a member of key management personnel of the Group. [*Paragraph 9(b)(vi)–(a)(iii)*]

Example 4 – Person as investor

IE16 A person, X, has an investment in Entity A and Entity B.



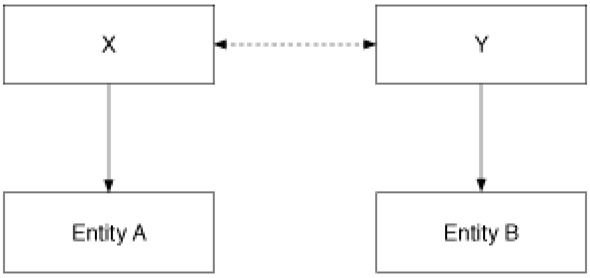
IE17 For Entity A's financial statements, if X controls or jointly controls Entity A, Entity B is related to Entity A when X has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vii)–(a)(i)*]

IE18 For Entity B's financial statements, if X controls or jointly controls Entity A, Entity A is related to Entity B when X has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vi)–(a)(ii)*]

IE19 If X has significant influence over both Entity A and Entity B, Entities A and B are not related to each other.

Example 5 – Close members of the family holding investments

IE20 A person, X, is the domestic partner of Y. X has an investment in Entity A and Y has an investment in Entity B.



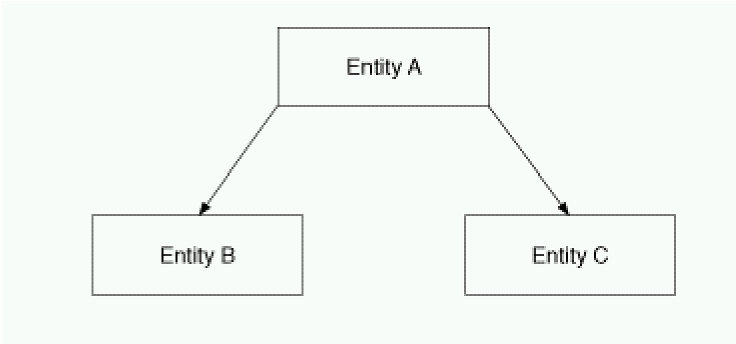
IE21 For Entity A's financial statements, if X controls or jointly controls Entity A, Entity B is related to Entity A when Y has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vii)–(a)(i)*]

IE22 For Entity B's financial statements, if X controls or jointly controls Entity A, Entity A is related to Entity B when Y has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vi)–(a)(ii)*]

IE23 If X has significant influence over Entity A and Y has significant influence over Entity B, Entities A and B are not related to each other.

Example 6 – Entity with joint control

IE24 Entity A has both (i) joint control over Entity B and (ii) joint control or significant influence over Entity C.



IE25 For Entity B's financial statements, Entity C is related to Entity B. [*Paragraph 9(b)(iii) and (iv)*]

IE26 Similarly, for Entity C's financial statements, Entity B is related to Entity C. [*Paragraph 9(b)(iii) and (iv)*]

Table of Concordance

This table shows how the contents of the superseded version of HKAS 24 and the revised version of HKAS 24 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Superseded HKAS 24 paragraph	Revised HKAS 24 paragraph
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8
9	9
10	10
11	11
None	12
12	13
13	14
14	15
15	16
16	17
17	18
18	19
19	20
20	21
20	22
21	23

22	24
None	25
None	26
None	27
23	28
23A	None
24	29

HKAS 34
Revised ~~June 2012~~February 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Accounting Standard 34

Interim Financial Reporting

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

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CONTENTS

Hong Kong Accounting Standard 34 *Interim Financial Reporting* (HKAS 34) is set out in paragraphs 1-~~49~~53. All the paragraphs have equal authority. HKAS 34 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 This Standard (HKAS 34) addresses interim financial reporting. HKAS 34 is effective for accounting periods beginning on or after 1 January 2005.

IN2 An interim financial report is a financial report that contains either a complete or condensed set of financial statements for a period shorter than an entity's full financial year.

IN3 This Standard does not mandate which entities should publish interim financial reports, how frequently, or how soon after the end of an interim period. This Standard applies if a company is required or elects to publish an interim financial report in accordance with Standards.

IN4 This Standard:

(a) defines the minimum content of an interim financial report, including disclosures; and

(b) identifies the accounting recognition and measurement principles that should be applied in an interim financial report.

IN5 The minimum content of an interim financial report is a condensed statement of financial position, a condensed statement or statements of profit or loss and other comprehensive income, a condensed statement of cash flows, a condensed statement of changes in equity, and selected explanatory notes. 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 interim condensed information from that ~~separate~~ statement.

IN6 On the presumption that anyone who reads an entity's interim report will also have access to its most recent annual report, virtually none of the notes to the annual financial statements are repeated or updated in the interim report. Instead, the interim notes include primarily an explanation of the events and changes that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.

IN7 An entity should apply the same accounting policies in its interim financial report as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. The frequency of an entity's reporting—annual, half-yearly, or quarterly—should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes are made on a year-to-date basis.

IN8 ~~An appendix to this~~ Part B of the illustrative examples accompanying the Standard provides guidance for applying the basic recognition and measurement principles at interim dates to various types of asset, liability, income, and expense. Income tax expense for an interim period is based on an estimated average annual effective income tax rate, consistent with the annual assessment of taxes.

IN9 In deciding how to recognise, classify, or disclose an item for interim financial reporting purposes, materiality is to be assessed in relation to the interim period financial data, not forecast annual data.

Hong Kong Accounting Standard 34
Interim Financial Reporting

Objective

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.

Scope

1 This Standard does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period. However, governments, securities regulators, stock exchanges, and accountancy bodies often require entities whose debt or equity securities are publicly traded to publish interim financial reports. This Standard applies if an entity is required or elects to publish an interim financial report in accordance with Hong Kong Financial Reporting Standards (HKFRSs). The Hong Kong Institute of Certified Public Accountants encourages publicly traded entities to provide interim financial reports that conform to the recognition, measurement, and disclosure principles set out in this Standard. Specifically, publicly traded entities are encouraged:

(a) to provide interim financial reports at least as of the end of the first half of their financial year; and

(b) to make their interim financial reports available not later than 60 days after the end of the interim period.

2 Each financial report, annual or interim, is evaluated on its own for conformity to HKFRSs. The fact that an entity may not have provided interim financial reports during a particular financial year or may have provided interim financial reports that do not comply with this Standard does not prevent the entity's annual financial statements from conforming to HKFRSs if they otherwise do so.

3 If an entity's interim financial report is described as complying with HKFRSs, it must comply with all of the requirements of this Standard. Paragraph 19 requires certain disclosures in that regard.

Definitions

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

Interim period **is a financial reporting period shorter than a full financial year.**

Interim financial report **means a financial report containing either a complete set of financial statements (as described in HKAS 1 *Presentation of Financial Statements* (as revised in 2007)) or a set of condensed financial statements (as described in this Standard) for an interim period.**

Content of an interim financial report

5 HKAS 1 ~~(as revised in 2007)~~ defines a complete set of financial statements as including the following components:

(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 of HKAS 1; 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 paragraph 40A-40D of HKAS 1.

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'.

6 In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required to or may elect to provide less information at interim dates as compared with its annual financial statements. This Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.

7 Nothing in this Standard is intended to prohibit or discourage an entity from publishing a complete set of financial statements (as described in HKAS 1) in its interim financial report, rather than condensed financial statements and selected explanatory notes. Nor does this Standard prohibit or discourage an entity from including in condensed interim financial statements more than the minimum line items or selected explanatory notes as set out in this Standard. The recognition and measurement guidance in this Standard applies also to complete financial statements for an interim period, and such statements would include all of the disclosures required by this Standard (particularly the selected note disclosures in paragraph 16A) as well as those required by other HKFRSs.

Minimum components of an interim financial report

8 **An interim financial report shall include, at a minimum, the following components:**

(a) a condensed statement of financial position;

(b) a condensed statement or condensed statements of profit or loss and other comprehensive income~~, presented as either~~;

~~**(i) a condensed single statement; or**~~

~~**(ii) a condensed separate income statement and a condensed statement of comprehensive income;**~~

(c) a condensed statement of changes in equity;

(d) a condensed statement of cash flows; and

(e) selected explanatory notes.

8A 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 interim condensed information from that ~~separate~~ statement.

Form and content of interim financial statements

9 If an entity publishes a complete set of financial statements in its interim financial report, the form and content of those statements shall conform to the requirements of HKAS 1 for a complete set of financial statements.

10 **If an entity publishes a set of condensed financial statements in its interim financial report, those condensed statements shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard. Additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading.**

11 **In the statement that presents the components of profit or loss for an interim period, an entity shall present basic and diluted earnings per share for that period when the entity is within the scope of HKAS 33** *Earnings per Share***.**[*]

11A **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 in that separate statement.**

12 HKAS 1 (as revised in 2007) provides guidance on the structure of financial statements. The Implementation Guidance for HKAS 1 illustrates ways in which the statement of financial position, statement of comprehensive income and statement of changes in equity may be presented.

13 [Deleted]

14 An interim financial report is prepared on a consolidated basis if the entity's most recent annual financial statements were consolidated statements. The parent's separate financial statements are not consistent or comparable with the consolidated statements in the most recent annual financial report. If an entity's annual financial report included the parent's separate financial statements in addition to consolidated financial statements, this Standard neither requires nor prohibits the inclusion of the parent's separate statements in the entity's interim financial report.

Significant events and transactions

15 An entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report.

15A A user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore, it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report.

15B The following is a list of events and transactions for which disclosures would be required if they are significant: the list is not exhaustive.

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

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

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

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

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

(f) litigation settlements;

(g) corrections of prior period errors;

[*] This paragraph was amended by *Improvements to HKFRSs* issued in October 2008 to clarify the scope of HKAS 34.

(h) changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost;

(i) any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period;

(j) related party transactions;

(k) transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments;

(l) changes in the classification of financial assets as a result of a change in the purpose or use of those assets; and

(m) changes in contingent liabilities or contingent assets.

15C Individual HKFRSs provide guidance regarding disclosure requirements for many of the items listed in paragraph 15B. When an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period.

16-18 [Deleted]

Other disclosures

16A In addition to disclosing significant events and transactions in accordance with paragraphs 15–15C, an entity shall include the following information, in the notes to its interim financial statements, if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis.

(a) a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change.

(b) explanatory comments about the seasonality or cyclicality of interim operations.

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence.

(d) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years.

(e) issues, repurchases, and repayments of debt and equity securities.

(f) dividends paid (aggregate or per share) separately for ordinary shares and other shares.

(g) the following segment information (disclosure of segment information is required in an entity's interim financial report only if HKFRS 8 *Operating Segments* requires that entity to disclose segment information in its annual financial statements):

(i) revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker.

(ii) intersegment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker.

(iii) **a measure of segment profit or loss.**

(iv) **a measure of total assets ~~for which~~and liabilities for a particular reportable segment if such amounts are regularly provided to the chief operating decision maker and if there has been a material change from the amount disclosed in the last annual financial statements for that reportable segment.**

(v) **a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss.**

(vi) **a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation.**

(h) **events after the interim period that have not been reflected in the financial statements for the interim period.**

(i) **the effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required by HKFRS 3 *Business Combinations*.**

(j) **for financial instruments, the disclosures about fair value required by paragraphs 91-93(h), 94-96, 98 and 99 of HKFRS 13 *Fair Value Measurement* and paragraphs 25, 26 and 28-30 of HKFRS 7 *Financial Instruments: Disclosures*.**

Disclosure of compliance with HKFRSs

19 **If an entity's interim financial report is in compliance with this Standard, that fact shall be disclosed. An interim financial report shall not be described as complying with HKFRSs unless it complies with all the requirements of HKFRSs.**

Periods for which interim financial statements are required to be presented

20 **Interim reports shall include interim financial statements (condensed or complete) for periods as follows:**

(a) **statement of financial position as of the end of the current interim period and a comparative statement of financial position as of the end of the immediately preceding financial year.**

(b) **statements of profit or loss and other comprehensive income for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit or loss and other comprehensive income for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. As permitted by HKAS 1 (as ~~revised~~ amended in ~~2007~~2011), an interim report may present for each period ~~either a single~~ statement or statements of profit or loss and other comprehensive income~~, or a statement displaying components of profit or loss (separate income statement) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income)~~.**

(c) **statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.**

(d) **statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.**

21 For an entity whose business is highly seasonal, financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve-month period may be useful. Accordingly, entities whose business is highly seasonal are encouraged to consider reporting such information in addition to the information called for in the preceding paragraph.

22 ~~Appendix A~~ Part A of the illustrative examples accompanying this Standard illustrates the periods required to be presented by an entity that reports half-yearly and an entity that reports quarterly.

Materiality

23 **In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it shall be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.**

24 HKAS 1 and HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* define an item as material if its omission or misstatement could influence the economic decisions of users of the financial statements. HKAS 1 requires separate disclosure of material items, including (for example) discontinued operations, and HKAS 8 requires disclosure of changes in accounting estimates, errors and changes in accounting policies. The two Standards do not contain quantified guidance as to materiality.

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

Disclosure in annual financial statements

26 **If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not published for that final interim period, the nature and amount of that change in estimate shall be disclosed in a note to the annual financial statements for that financial year.**

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

Recognition and measurement

Same accounting policies as annual

28 **An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis.**

29 Requiring that an entity apply the same accounting policies in its interim financial statements as in its annual statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, by providing that the frequency of an entity's reporting shall not affect the measurement of its annual results, paragraph 28 acknowledges that an interim period is a part of a larger financial year. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.

30 To illustrate:

(a) the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an entity would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount;

(b) a cost that does not meet the definition of an asset at the end of an interim period is not deferred in the statement of financial position either to await future information as to whether it has met the definition of an asset or to smooth earnings over interim periods within a financial year; and

(c) income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.

31 Under the *Framework for the Preparation and Presentation of Financial Statement*s (the *Framework*),[*] recognition 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'. The definitions of assets, liabilities, income, and expenses are fundamental to recognition, at the end of both annual and interim financial reporting periods.

32 For assets, the same tests of future economic benefits apply at interim dates and at the end of an entity's financial year. Costs that, by their nature, would not qualify as assets at financial year-end would not qualify at interim dates either. Similarly, a liability at the end of an interim reporting period must represent an existing obligation at that date, just as it must at the end of an annual reporting period.

33 An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised; otherwise they are not recognised. The *Framework* says that 'expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.... [The] *Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.'

34 In measuring the assets, liabilities, income, expenses, and cash flows reported in its financial statements, an entity that reports only annually is able to take into account information that becomes available throughout the financial year. Its measurements are, in effect, on a year-to-date basis.

35 An entity that reports half-yearly uses information available by mid-year or shortly thereafter in making the measurements in its financial statements for the first six-month period and information available by year-end or shortly thereafter for the twelve-month period. The twelve-month measurements will reflect possible changes in estimates of amounts reported for the first six-month period. The amounts reported in the interim financial report for the first six-month period are not retrospectively adjusted. Paragraphs 16A(d) and 26 require, however, that the nature and amount of any significant changes in estimates be disclosed.

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

36 An entity that reports more frequently than half-yearly measures income and expenses on a year-to-date basis for each interim period using information available when each set of financial statements is being prepared. Amounts of income and expenses reported in the current interim period will reflect any changes in estimates of amounts reported in prior interim periods of the financial year. The amounts reported in prior interim periods are not retrospectively adjusted. Paragraphs 16A(d) and 26 require, however, that the nature and amount of any significant changes in estimates be disclosed.

Revenues received seasonally, cyclically, or occasionally

37 Revenues that are received seasonally, cyclically, or occasionally within a financial year shall not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the entity's financial year.

38 Examples include dividend revenue, royalties, and government grants. Additionally, some entities consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognised when they occur.

Costs incurred unevenly during the financial year

39 Costs that are incurred unevenly during an entity's financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

Applying the recognition and measurement principles

40 ~~Appendix B~~Part B of the illustrative examples accompanying this Standard provides examples of applying the general recognition and measurement principles set out in paragraphs 28-39.

Use of estimates

41 The measurement procedures to be followed in an interim financial report shall be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed. While measurements in both annual and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.

42 ~~Appendix C~~Part C of the illustrative examples accompanying this Standard provides examples of the use of estimates in interim periods.

Restatement of previously reported interim periods

43 A change in accounting policy, other than one for which the transition is specified by a new HKFRSs, shall be reflected by:

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

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

44 One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. Under HKAS 8, a change in accounting policy is reflected by retrospective application, with restatement of prior period financial data as far back as is practicable. However, if the cumulative amount of the adjustment relating to prior financial years is impracticable to determine, then under HKAS 8 the new policy is applied prospectively from the earliest date practicable. The effect of the principle in paragraph 43 is to require that within the current financial year any change in accounting policy is applied either retrospectively or, if that is not practicable, prospectively, from no later than the beginning of the financial year.

45 To allow accounting changes to be reflected as of an interim date within the financial year would allow two differing accounting policies to be applied to a particular class of transactions within a single financial year. The result would be interim allocation difficulties, obscured operating results, and complicated analysis and understandability of interim period information.

Withdrawal of SSAP 25

45A This Standard supersedes SSAP 25 *Interim Financial Reporting* (revised in 2001).

Effective date

46 This Standard becomes operative for financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged.

47 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 4, 5, 8, 11, 12 and 20, deleted paragraph 13 and added paragraphs 8A and 11A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

48 HKFRS 3 (as revised in 2008) amended paragraph 16(i). 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.

49 Paragraphs 15, 27, 35 and 36 were amended, paragraphs 15A–15C and 16A were added and paragraphs 16–18 were deleted 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. If an entity applies the amendments for an earlier period it shall disclose that fact.

50 HKFRS 13, issued in June 2011, added paragraph 16A(j). An entity shall apply that amendment when it applies HKFRS 13.

51 *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraph 8, 8A, 11A and 20. An entity shall apply those amendments when it applies HKAS 1 as amended in July 2011.

52 *Annual Improvements 2009-2011 Cycle*, Issued in June 2012, amended paragraph 5 as a consequential amendment derived from the amendment to HKAS 1 *Presentation of Financial Statements*. 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.

53 *Annual Improvements 2009-2011 Cycle*, issued in June 2012, amended paragraph 16A. 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.

Basis for Conclusions on IAS 34 *Interim Financial Reporting*

This Basis for Conclusions accompanies, but is not part of, IAS 34.

HKAS 34 is based on IAS 34 *Interim Financial Reporting*. In approving HKAS 34, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 34. Accordingly, there are no significant differences between HKAS 34 and IAS 34. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 34 referred to below generally correspond with those in HKAS 34.

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in amending paragraphs 15–18 of IAS 34 Interim Financial Reporting as part of *Improvements to IFRSs* issued in May 2010. Those changes aim to emphasise the disclosures principles in IAS 34 and to add further guidance to illustrate how to apply these principles.

BC2 IAS 34 was developed by the International Accounting Standards Committee (IASC) in 1998 and did not include a Basis for Conclusions.

Significant events and transactions

BC3 In *Improvements to IFRSs* issued in May 2010, the Board addressed requests for clarification of the disclosures required by IAS 34 when considered against changes in the disclosure requirements of other IFRSs. IAS 34 was issued by the Board's predecessor body, IASC, in 1998. In the light of recent improvements to disclosure requirements, many users of financial statements asked the Board to consider whether particular disclosures required by IFRS 7 *Financial Instruments: Disclosures* for annual financial statements should also be required in interim financial statements. IAS 34 sets out disclosure principles to determine what information should be disclosed in an interim financial report. The Board concluded that amending IAS 34 to place greater emphasis on those principles and the inclusion of additional examples relating to more recent disclosure requirements, ie fair value measurements, would improve interim financial reporting.

BC4 As part of *Improvements to IFRSs* issued in May 2010, the Board deleted paragraph 18 of IAS 34 because it repeats paragraph 10 of IAS 34 and because the Board's intention is to emphasise those disclosures that are required rather than those that are not required.

Content of an interim financial report

BC5 As part of *Annual Improvements 2009-2011 Cycle* (issued in May 2012) the Board amended paragraph 5 to achieve consistency with paragraphs 10(ea) and 10(f) of IAS 1 *Presentation of Financial Statements*.

Selected explanatory notes

BC6 In *Annual Improvements 2009-2011 Cycle* (issued in May 2012) the Board decided to clarify the requirements on segment information for total assets and liabilities for each reportable segment to enhance consistency with the requirements in paragraph 23 of IFRS 8 *Operating Segments*. The amendment clarifies that the total assets and liabilities for a particular reportable segment are required to be disclosed if, and only if:

(a) a measure of total assets or of total liabilities (or both) is regularly provided to the chief operating decision maker; and

(b) there has been a material change from those measures disclosed in the last annual financial statements for that reportable segment.

~~Appendix A~~Illustrative examples
A Illustration of periods required to be presented

This ~~appendix~~illustrative example, which accompanies, but is not part of, IAS 34, provides examples to illustrate application of the principle in paragraph 20.

Entity publishes interim financial reports half-yearly

A1 The entity's financial year ends 31 December (calendar year). The entity will present the following financial statements (condensed or complete) in its half-yearly interim financial report as of 30 June 20X1:

Statement of financial position:		
At	30 June 20X1	31 December 20X0
Statement of comprehensive income:		
6 months ending	30 June 20X1	30 June 20X0
Statement of cash flows:		
6 months ending	30 June 20X1	30 June 20X0
Statement of changes in equity:		
6 months ending	30 June 20X1	30 June 20X0

Entity publishes interim financial reports quarterly

A2 The entity's financial year ends 31 December (calendar year). The entity will present the following financial statements (condensed or complete) in its quarterly interim financial report as of 30 June 20X1:

Statement of financial position:		
At	30 June 20X1	31 December 20X0
Statement of comprehensive income:		
6 months ending	30 June 20X1	30 June 20X0
3 months ending	30 June 20X1	30 June 20X0
Statement of cash flow:		
6 months ending	30 June 20X1	30 June 20X0
Statement of changes in equity:		
6 months ending	30 June 20X1	30 June 20X0

~~Appendix B~~

B Examples of applying the recognition and measurement principles

This ~~appendix~~illustrative example, which accompanies, but is not part of, IAS 34, provides examples of applying the general recognition and measurement principles set out in paragraphs 28-39.

Employer payroll taxes and insurance contributions

B1 If employer payroll taxes or contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised in interim periods using an estimated average annual effective payroll tax or contribution rate, even though a large portion of the payments may be made early in the financial year. A common example is an employer payroll tax or insurance contribution that is imposed up to a certain maximum level of earnings per employee. For higher income employees, the maximum income is reached before the end of the financial year, and the employer makes no further payments through the end of the year.

Major planned periodic maintenance or overhaul

B2 The cost of a planned major periodic maintenance or overhaul or other seasonal expenditure that is expected to occur late in the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.

Provisions

B3 A provision is recognised when an entity has no realistic alternative but to make a transfer of economic benefits as a result of an event that has created a legal or constructive obligation. The amount of the obligation is adjusted upward or downward, with a corresponding loss or gain recognised in profit or loss, if the entity's best estimate of the amount of the obligation changes.

B4 The Standard requires that an entity apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer benefits is not a function of the length of the reporting period. It is a question of fact.

Year-end bonuses

B5 The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned based on a monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent.

B6 A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made. IAS 19 *Employee Benefits* provides guidance.

Contingent lease payments

B7 Contingent lease payments can be an example of a legal or constructive obligation that is recognised as a liability. If a lease provides for contingent payments based on the lessee achieving a certain level of annual sales, an obligation can arise in the interim periods of the financial year before the required annual level of sales has been achieved, if that required level of sales is expected to be achieved and the entity, therefore, has no realistic alternative but to make the future lease payment.

Intangible assets

B8 An entity will apply the definition and recognition criteria for an intangible asset in the same way in an interim period as in an annual period. Costs incurred before the recognition criteria for an intangible asset are met are recognised as an expense. Costs incurred after the specific point in time at which the criteria are met are recognised as part of the cost of an intangible asset. 'Deferring' costs as assets in an interim statement of financial position in the hope that the recognition criteria will be met later in the financial year is not justified.

Pensions

B9 Pension cost for an interim period is calculated on a year-to-date basis by using the actuarially determined pension cost rate at the end of the prior financial year, adjusted for significant market fluctuations since that time and for ~~significant curtailments, settlements, or other~~ significant one-off events, such as plan amendments, curtailments and settlements.

Vacations, holidays, and other short-term compensated absences

B10 Accumulating ~~compensated~~ paid absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. IAS 19 *Employee Benefits* requires that an entity measure the expected cost of and obligation for accumulating ~~compensated~~ paid absences at the amount the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. That principle is also applied at the end of interim financial reporting periods. Conversely, an entity recognises no expense or liability for non-accumulating ~~compensated~~ paid absences at the end of an interim reporting period, just as it recognises none at the end of an annual reporting period.

Other planned but irregularly occurring costs

B11 An entity's budget may include certain costs expected to be incurred irregularly during the financial year, such as charitable contributions and employee training costs. Those costs generally are discretionary even though they are planned and tend to recur from year to year. Recognising an obligation at the end of an interim financial reporting period for such costs that have not yet been incurred generally is not consistent with the definition of a liability.

Measuring interim income tax expense

B12 Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

B13 This is consistent with the basic concept set out in paragraph 28 that the same accounting recognition and measurement principles shall be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis. Interim period income tax expense is calculated by applying to an interim period's pre-tax income the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate. That estimated average annual rate would reflect a blend of the progressive tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. IAS 12 *Income Taxes* provides guidance on substantively enacted changes in tax rates. The estimated average annual income tax rate would be re-estimated on a year-to-date basis, consistent with paragraph 28 of the Standard. Paragraph ~~16(d)~~16A requires disclosure of a significant change in estimate.

B14 To the extent practicable, a separate estimated average annual effective income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pre-tax income of each jurisdiction. Similarly, if different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all cases, and a weighted average of rates across jurisdictions or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

B15 To illustrate the application of the foregoing principle, an entity reporting quarterly expects to earn 10,000 pre-tax each quarter and operates in a jurisdiction with a tax rate of 20 per cent on the first 20,000 of annual earnings and 30 per cent on all additional earnings. Actual earnings match expectations. The following table shows the amount of income tax expense that is reported in each quarter:

	1st Quarter	**2nd Quarter**	**3rd Quarter**	**4th Quarter**	**Annual**
Tax expense	2,500	2,500	2,500	2,500	10,000

10,000 of tax is expected to be payable for the full year on 40,000 of pre-tax income.

B16 As another illustration, an entity reports quarterly, earns 15,000 pre-tax profit in the first quarter but expects to incur losses of 5,000 in each of the three remaining quarters (thus having zero income for the year), and operates in a jurisdiction in which its estimated average annual income tax rate is expected to be 20 per cent. The following table shows the amount of income tax expense that is reported in each quarter:

	1st Quarter	**2nd Quarter**	**3rd Quarter**	**4th Quarter**	**Annual**
Tax expense	3,000	(1,000)	(1,000)	(1,000)	0

Difference in financial reporting year and tax year

B17 If the financial reporting year and the income tax year differ, income tax expense for the interim periods of that financial reporting year is measured using separate weighted average estimated effective tax rates for each of the income tax years applied to the portion of pre-tax income earned in each of those income tax years.

B18 To illustrate, an entity's financial reporting year ends 30 June and it reports quarterly. Its taxable year ends 31 December. For the financial year that begins 1 July, Year 1 and ends 30 June, Year 2, the entity earns 10,000 pre-tax each quarter. The estimated average annual income tax rate is 30 per cent in Year 1 and 40 per cent in Year 2.

	Quarter Ending 30 Sept Year 1	**Quarter Ending 31 Dec Year 1**	**Quarter Ending 31 Mar Year 2**	**Quarter Ending 30 June Year 2**	**Year Ending 30 June Year 2**
Tax expense	3,000	3,000	4,000	4,000	14,000

Tax credits

B19 Some tax jurisdictions give taxpayers credits against the tax payable based on amounts of capital expenditures, exports, research and development expenditures, or other bases. Anticipated tax benefits of this type for the full year are generally reflected in computing the estimated annual effective income tax rate, because those credits are granted and calculated on an annual basis under most tax laws and regulations. On the other hand, tax benefits that relate to a one-off event are recognised in computing income tax expense in that interim period, in the same way that special tax rates applicable to particular categories of income are not blended into a single effective annual tax rate. Moreover, in some jurisdictions tax benefits or credits, including those related to capital expenditures and levels of exports, while reported on the income tax return, are more similar to a government grant and are recognised in the interim period in which they arise.

Tax loss and tax credit carrybacks and carryforwards

B20 The benefits of a tax loss carryback are reflected in the interim period in which the related tax loss occurs. IAS 12 provides that 'the benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset'. A corresponding reduction of tax expense or increase of tax income is also recognised.

B21 IAS 12 provides that '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'. IAS 12 provides criteria for assessing the probability of taxable profit against which the unused tax losses and credits can be utilised. Those criteria are applied at the end of each interim period and, if they are met, the effect of the tax loss carryforward is reflected in the computation of the estimated average annual effective income tax rate.

B22 To illustrate, an entity that reports quarterly has an operating loss carryforward of 10,000 for income tax purposes at the start of the current financial year for which a deferred tax asset has not been recognised. The entity earns 10,000 in the first quarter of the current year and expects to earn 10,000 in each of the three remaining quarters. Excluding the carryforward, the estimated average annual income tax rate is expected to be 40 per cent. Tax expense is as follows:

	1st Quarter	**2nd Quarter**	**3rd Quarter**	**4th Quarter**	**Annual**
Tax expense	3,000	3,000	3,000	3,000	12,000

Contractual or anticipated purchase price changes

B23 Volume rebates or discounts and other contractual changes in the prices of raw materials, labour, or other purchased goods and services are anticipated in interim periods, by both the payer and the recipient, if it is probable that they have been earned or will take effect. Thus, contractual rebates and discounts are anticipated but discretionary rebates and discounts are not anticipated because the resulting asset or liability would not satisfy the conditions in the *Conceptual Framework* that an asset must be a resource controlled by the entity as a result of a past event and that a liability must be a present obligation whose settlement is expected to result in an outflow of resources.

Depreciation and amortisation

B24 Depreciation and amortisation for an interim period is based only on assets owned during that interim period. It does not take into account asset acquisitions or dispositions planned for later in the financial year.

Inventories

B25 Inventories are measured for interim financial reporting by the same principles as at financial year-end. IAS 2 *Inventories* establishes standards for recognising and measuring inventories. Inventories pose particular problems at the end of any financial reporting period because of the need to determine inventory quantities, costs, and net realisable values. Nonetheless, the same measurement principles are applied for interim inventories. To save cost and time, entities often use estimates to measure inventories at interim dates to a greater extent than at the end of annual reporting periods. Following are examples of how to apply the net realisable value test at an interim date and how to treat manufacturing variances at interim dates.

Net realisable value of inventories

B26 The net realisable value of inventories is determined by reference to selling prices and related costs to complete and dispose at interim dates. An entity will reverse a write-down to net realisable value in a subsequent interim period only if it would be appropriate to do so at the end of the financial year.

B27 [Deleted]

Interim period manufacturing cost variances

B28 Price, efficiency, spending, and volume variances of a manufacturing entity are recognised in income at interim reporting dates to the same extent that those variances are recognised in income at financial year end. Deferral of variances that are expected to be absorbed by year-end is not appropriate because it could result in reporting inventory at the interim date at more or less than its portion of the actual cost of manufacture.

Foreign currency translation gains and losses

B29 Foreign currency translation gains and losses are measured for interim financial reporting by the same principles as at financial year end.

B30 IAS 21 *The Effects of Changes in Foreign Exchange Rates* specifies how to translate the financial statements for foreign operations into the presentation currency, including guidelines for using average or closing foreign exchange rates and guidelines for recognising the resulting adjustments in profit or loss, or in other comprehensive income. Consistently with IAS 21, the actual average and closing rates for the interim period are used. Entities do not anticipate some future changes in foreign exchange rates in the remainder of the current financial year in translating foreign operations at an interim date.

B31 If IAS 21 requires translation adjustments to be recognised as income or expense in the period in which they arise, that principle is applied during each interim period. Entities do not defer some foreign currency translation adjustments at an interim date if the adjustment is expected to reverse before the end of the financial year.

Interim financial reporting in hyperinflationary economies

B32 Interim financial reports in hyperinflationary economies are prepared by the same principles as at financial year-end.

B33 IAS 29 *Financial Reporting in Hyperinflationary Economies* requires that the financial statements of an entity that reports in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the end of the reporting period, and the gain or loss on the net monetary position is included in net income. Also, comparative financial data reported for prior periods are restated to the current measuring unit.

B34 Entities follow those same principles at interim dates, thereby presenting all interim data in the measuring unit as of the end of the interim period, with the resulting gain or loss on the net monetary position included in the interim period's net income. Entities do not annualise the recognition of the gain or loss. Nor do they use an estimated annual inflation rate in preparing an interim financial report in a hyperinflationary economy.

Impairment of assets

B35 IAS 36 *Impairment of Assets* requires that an impairment loss be recognised if the recoverable amount has declined below carrying amount.

B36 This Standard requires that an entity apply the same impairment testing, recognition, and reversal criteria at an interim date as it would at the end of its financial year. That does not mean, however, that an entity must necessarily make a detailed impairment calculation at the end of each interim period. Rather, an entity will review for indications of significant impairment since the end of the most recent financial year to determine whether such a calculation is needed.

~~Appendix C~~
C Examples of the use of estimates

This ~~Appendix~~illustrative example, which accompanies, but is not part of, IAS 34, provides examples to illustrate application of the principle in paragraph 41.

C1 **Inventories**: Full stock-taking and valuation procedures may not be required for inventories at interim dates, although it may be done at financial year-end. It may be sufficient to make estimates at interim dates based on sales margins.

C2 **Classifications of current and non-current assets and liabilities:** Entities may do a more thorough investigation for classifying assets and liabilities as current or non-current at annual reporting dates than at interim dates.

C3 **Provisions:** Determination of the appropriate amount of a provision (such as a provision for warranties, environmental costs, and site restoration costs) may be complex and often costly and time-consuming. Entities sometimes engage outside experts to assist in the annual calculations. Making similar estimates at interim dates often entails updating of the prior annual provision rather than the engaging of outside experts to do a new calculation.

C4 **Pensions**: IAS 19 *Employee Benefits* requires ~~that~~ an entity to determine the present value of defined benefit obligations and the ~~market~~fair value of plan assets at the end of each reporting period and encourages an entity to involve a professionally qualified actuary in measurement of the obligations. For interim reporting purposes, reliable measurement is often obtainable by extrapolation of the latest actuarial valuation.

C5 **Income taxes:** Entities may calculate income tax expense and deferred income tax liability at annual dates by applying the tax rate for each individual jurisdiction to measures of income for each jurisdiction. Paragraph B14 acknowledges that while that degree of precision is desirable at interim reporting dates as well, it may not be achievable in all cases, and a weighted average of rates across jurisdictions or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

C6 **Contingencies:** The measurement of contingencies may involve the opinions of legal experts or other advisers. Formal reports from independent experts are sometimes obtained with respect to contingencies. Such opinions about litigation, claims, assessments, and other contingencies and uncertainties may or may not also be needed at interim dates.

C7 **Revaluations and fair value accounting**: IAS 16 *Property, Plant and Equipment* allows an entity to choose as its accounting policy the revaluation model whereby items of property, plant and equipment are revalued to fair value. Similarly, IAS 40 *Investment Property* requires an entity to ~~determine~~ measure the fair value of investment property. For those measurements, an entity may rely on professionally qualified valuers at annual reporting dates though not at interim reporting dates.

C8 **Intercompany reconciliations:** Some intercompany balances that are reconciled on a detailed level in preparing consolidated financial statements at financial year-end might be reconciled at a less detailed level in preparing consolidated financial statements at an interim date.

C9 **Specialised industries:** Because of complexity, costliness, and time, interim period measurements in specialised industries might be less precise than at financial year-end. An example would be calculation of insurance reserves by insurance companies.

Appendix ~~D~~
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 34.

The International Accounting Standard comparable with HKAS 34 is IAS 34 *Interim Financial Reporting*.

There are no major textual differences between HKAS 34 and IAS 34.

HK(IFRIC)-Int 2
Revised ~~June 2012~~February 2014

Effective for annual periods
beginning on or after 1 January 2005

HK(IFRIC) Interpretation 2

Members' Shares in Co-operative Entities and Similar Instruments

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

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CONTENTS

from paragraph

HK(IFRIC) INTERPRETATION 2
MEMBERS' SHARES IN CO-OPERATIVE ENTITIES AND SIMILAR INSTRUMENTS

HK(IFRIC) Interpretation 2 *Members' Shares in Co-operative Entities and Similar Instruments* (HK(IFRIC)-Int 2) is set out in paragraphs 1–~~14A~~17and the Appendices. HK(IFRIC)-Int 2 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

- HKFRS 13 *Fair Value Measurement*
- HKAS 32 *Financial Instruments: Disclosure and Presentation*[*]
- HKAS 39 *Financial Instruments: Recognition and Measurement*

Background

1 Co-operatives and other similar entities are formed by groups of persons to meet common economic or social needs. National laws typically define a co-operative as a society endeavouring to promote its members' economic advancement by way of a joint business operation (the principle of self-help). Members' interests in a co-operative are often characterised as members' shares, units or the like, and are referred to below as 'members' shares'.

2 HKAS 32 establishes principles for the classification of financial instruments as financial liabilities or equity. In particular, those principles apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. The application of those principles to members' shares in co-operative entities and similar instruments is difficult. Guidance has been requested on understanding how the principles in HKAS 32 apply to members' shares and similar instruments that have certain features, and the circumstances in which those features affect the classification as liabilities or equity.

Scope

3 This Interpretation applies to financial instruments within the scope of HKAS 32, including financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity. This Interpretation does not apply to financial instruments that will or may be settled in the entity's own equity instruments.

Issue

4 Many financial instruments, including members' shares, have characteristics of equity, including voting rights and rights to participate in dividend distributions. Some financial instruments give the holder the right to request redemption for cash or another financial asset, but may include or be subject to limits on whether the financial instruments will be redeemed. How should those redemption terms be evaluated in determining whether the financial instruments should be classified as liabilities or equity?

Conclusions

5 The contractual right of the holder of a financial instrument (including members' shares in co-operative entities) to request redemption does not, in itself, require that financial instrument to be classified as a financial liability. Rather, the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.

6 Members' shares that would be classified as equity if the members did not have a right to request redemption are equity if either of the conditions described in paragraphs 7 and 8 is present or the members' shares have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of HKAS 32. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.

7 Members' shares are equity if the entity has an unconditional right to refuse redemption of the members' shares.

[*] HKAS 32 was amended as HKAS 32 *Financial Instruments: Presentation* for annual periods beginning on or after 1 January 2007. In June 2008 the HKICPA amended HKAS 32 by requiring instruments to be classified as equity if those instruments have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of HKAS 32.

8 Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, eg unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions—such as liquidity constraints—are met (or are not met) do not result in members' shares being equity.

9 An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members' shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of the prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph 7 or the members' shares have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of HKAS 32. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and equity.

10 At initial recognition, the entity shall measure its financial liability for redemption at fair value. In the case of members' shares with a redemption feature, the entity measures the fair value of the financial liability for redemption at no less than the maximum amount payable under the redemption provisions of its governing charter or applicable law discounted from the first date that the amount could be required to be paid (see example 3).

11 As required by paragraph 35 of HKAS 32, distributions to holders of equity instruments are recognised directly in equity~~, net of any income tax benefits~~. Interest, dividends and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterised as dividends, interest or otherwise.

12 The Appendix, which is an integral part of the conclusions, provides examples of the application of these conclusions.

Disclosure

13 When a change in the redemption prohibition leads to a transfer between financial liabilities and equity, the entity shall disclose separately the amount, timing and reason for the transfer.

Effective date

14 The effective date and transition requirements of this Interpretation are the same as those for HKAS 32. An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2005. If an entity applies this Interpretation for a period beginning before 1 January 2005, it shall disclose that fact. This Interpretation shall be applied retrospectively.

14A An entity shall apply the amendments in paragraphs 6, 9, A1 and A12 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 amendments in paragraphs 6, 9, A1 and A12 shall be applied for that earlier period.

15 *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

16 HKFRS 13, issued in June 2011, amended paragraph A8. An entity shall apply that amendment when it applies HKFRS 13.

17 *Annual Improvements 2009-2011 Cycle*, issued in June 2012, amended paragraph 11. 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. If an entity applies that amendment to HKAS 32 as a part of the *Annual Improvements 2009-2011 Cycle* (issued in June 2012) for an earlier period, the amendment in paragraph 11 shall be applied for that earlier period.

Appendix

Examples of application of the conclusions

This appendix is an integral part of the Interpretation.

A1 This appendix sets out seven examples of the application of the HK(IFRIC)-Int conclusions. The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability and that the financial instrument does not have all the features or does not meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of HKAS 32.

Unconditional right to refuse redemption (paragraph 7)

Example 1

Facts

A2 The entity's charter states that redemptions are made at the sole discretion of the entity. The charter does not provide further elaboration or limitation on that discretion. In its history, the entity has never refused to redeem members' shares, although the governing board has the right to do so.

Classification

A3 The entity has the unconditional right to refuse redemption and the members' shares are equity. HKAS 32 establishes principles for classification that are based on the terms of the financial instrument and notes that a history of, or intention to make, discretionary payments does not trigger liability classification. Paragraph AG26 of HKAS 32 states:

> 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.

Example 2

Facts

A4 The entity's charter states that redemptions are made at the sole discretion of the entity. However, the charter further states that approval of a redemption request is automatic unless the entity is unable to make payments without violating local regulations regarding liquidity or reserves.

Classification

A5 The entity does not have the unconditional right to refuse redemption and the members' shares are a financial liability. The restrictions described above are based on the entity's ability to settle its liability. They restrict redemptions only if the liquidity or reserve requirements are not met and then only until such time as they are met. Hence, they do not, under the principles established in HKAS 32, result in the classification of the financial instrument as equity. Paragraph AG25 of HKAS 32 states:

> 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.* [Emphasis added]

Prohibitions against redemption (paragraphs 8 and 9)

Example 3

Facts

A6 A co-operative entity has issued shares to its members at different dates and for different amounts in the past as follows:

(a) 1 January 20X1 100,000 shares at CU10 each (CU1,000,000);

(b) 1 January 20X2 100,000 shares at CU20 each (a further CU2,000,000, so that the total for shares issued is CU3,000,000).

Shares are redeemable on demand at the amount for which they were issued.

A7 The entity's charter states that cumulative redemptions cannot exceed 20 per cent of the highest number of its members' shares ever outstanding. At 31 December 20X2 the entity has 200,000 of outstanding shares, which is the highest number of members' shares ever outstanding and no shares have been redeemed in the past. On 1 January 20X3 the entity amends its governing charter and increases the permitted level of cumulative redemptions to 25 per cent of the highest number of its members' shares ever outstanding.

Classification

Before the governing charter is amended

A8 Members' shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity ~~determines~~ measures the fair value of such financial liabilities as required by paragraph ~~49 of HKAS 39~~ 47 of HKFRS 13, which states: 'The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand …' Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

A9 On 1 January 20X1 the maximum amount payable under the redemption provisions is 20,000 shares at CU10 each and accordingly the entity classifies CU200,000 as financial liability and CU800,000 as equity. However, on 1 January 20X2 because of the new issue of shares at CU20, the maximum amount payable under the redemption provisions increases to 40,000 shares at CU20 each. The issue of additional shares at CU20 creates a new liability that is measured on initial recognition at fair value. The liability after these shares have been issued is 20 per cent of the total shares in issue (200,000), measured at CU20, or CU800,000. This requires recognition of an additional liability of CU600,000. In this example no gain or loss is recognised. Accordingly the entity now classifies CU800,000 as financial liabilities and CU2,200,000 as equity. This example assumes these amounts are not changed between 1 January 20X1 and 31 December 20X2.

After the governing charter is amended

A10 Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 per cent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on 1 January 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 49 of HKAS 39. It therefore transfers on 1 January 20X3 from equity to financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity. In this example the entity does not recognise a gain or loss on the transfer.

Example 4

Facts

A11 Local law governing the operations of co-operatives, or the terms of the entity's governing charter, prohibit an entity from redeeming members' shares if, by redeeming them, it would reduce paid-in capital from members' shares below 75 per cent of the highest amount of paid-in capital from members' shares. The highest amount for a particular co-operative is CU1,000,000. At the end of the reporting period the balance of paid-in capital is CU900,000.

Classification

A12 In this case, CU750,000 would be classified as equity and CU150,000 would be classified as financial liabilities. In addition to the paragraphs already cited, paragraph 18(b) of HKAS 32 states in part:

> …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.

A13 The redemption prohibition described in this example is different from the restrictions described in paragraphs 19 and AG25 of HKAS 32. Those restrictions are limitations on the ability of the entity to pay the amount due on a financial liability, ie they prevent payment of the liability only if specified conditions are met. In contrast, this example describes an unconditional prohibition on redemptions beyond a specified amount, regardless of the entity's ability to redeem members' shares (eg given its cash resources, profits or distributable reserves). In effect, the prohibition against redemption prevents the entity from incurring any financial liability to redeem more than a specified amount of paid-in capital. Therefore, the portion of shares subject to the redemption prohibition is not a financial liability. While each member's shares may be redeemable individually, a portion of the total shares outstanding is not redeemable in any circumstances other than liquidation of the entity.

Example 5

Facts

A14 The facts of this example are as stated in example 4. In addition, at the end of the reporting period, liquidity requirements imposed in the local jurisdiction prevent the entity from redeeming any members' shares unless its holdings of cash and short-term investments are greater than a specified amount. The effect of these liquidity requirements at the end of the reporting period is that the entity cannot pay more than CU50,000 to redeem the members' shares.

Classification

A15 As in example 4, the entity classifies CU750,000 as equity and CU150,000 as a financial liability. This is because the amount classified as a liability is based on the entity's unconditional right to refuse redemption and not on conditional restrictions that prevent redemption only if liquidity or other conditions are not met and then only until such time as they are met. The provisions of paragraphs 19 and AG25 of HKAS 32 apply in this case.

Example 6

Facts

A16 The entity's governing charter prohibits it from redeeming members' shares, except to the extent of proceeds received from the issue of additional members' shares to new or existing members during the preceding three years. Proceeds from issuing members' shares must be applied to redeem shares for which members have requested redemption. During the three preceding years, the proceeds from issuing members' shares have been CU12,000 and no member's shares have been redeemed.

Classification

A17 The entity classifies CU12,000 of the members' shares as financial liabilities. Consistently with the conclusions described in example 4, members' shares subject to an unconditional prohibition against redemption are not financial liabilities. Such an unconditional prohibition applies to an amount equal to the proceeds of shares issued before the preceding three years, and accordingly, this amount is classified as equity. However, an amount equal to the proceeds from any shares issued in the preceding three years is not subject to an unconditional prohibition on redemption. Accordingly, proceeds from the issue of members' shares in the preceding three years give rise to financial liabilities until they are no longer available for redemption of members' shares. As a result the entity has a financial liability equal to the proceeds of shares issued during the three preceding years, net of any redemptions during that period.

Example 7

Facts

A18 The entity is a co-operative bank. Local law governing the operations of co-operative banks state that at least 50 per cent of the entity's total 'outstanding liabilities' (a term defined in the regulations to include members' share accounts) has to be in the form of members' paid-in capital. The effect of the regulation is that if all of a co-operative's outstanding liabilities are in the form of members' shares, it is able to redeem them all. On 31 December 20X1 the entity has total outstanding liabilities of CU200,000, of which CU125,000 represent members' share accounts. The terms of the members' share accounts permit the holder to redeem them on demand and there are no limitations on redemption in the entity's charter.

Classification

A19 In this example members' shares are classified as financial liabilities. The redemption prohibition is similar to the restrictions described in paragraphs 19 and AG25 of HKAS 32. The restriction is a conditional limitation on the ability of the entity to pay the amount due on a financial liability, ie they prevent payment of the liability only if specified conditions are met. More specifically, the entity could be required to redeem the entire amount of members' shares (CU125,000) if it repaid all of its other liabilities (CU75,000). Consequently, the prohibition against redemption does not prevent the entity from incurring a financial liability to redeem more than a specified number of members' shares or amount of paid-in capital. It allows the entity only to defer redemption until a condition is met, ie the repayment of other liabilities. Members' shares in this example are not subject to an unconditional prohibition against redemption and are therefore classified as financial liabilities.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IFRIC 2.

HK(IFRIC) Interpretation 2 is based on IFRIC Interpretation 2 *Members' Shares in Co-operative Entities and Similar Instruments*. In approving HK(IFRIC) Interpretation 2, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 2. Accordingly, there are no significant differences between HK(IFRIC) Interpretation 2 and IFRIC Interpretation 2. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 2 referred to below generally correspond with those in HK(IFRIC) Interpretation 2.

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.

Background

BC2 In September 2001, the Standing Interpretations Committee instituted by the former International Accounting Standards Committee (IASC) published Draft Interpretation SIC D-34 *Financial Instruments - Instruments or Rights Redeemable by the Holder.* The Draft Interpretation stated: 'The issuer of a Puttable Instrument should classify the entire instrument as a liability.'

BC3 In 2001 the International Accounting Standards Board (IASB) began operations in succession to IASC. The IASB's initial agenda included a project to make limited amendments to the financial instruments standards issued by IASC. The IASB decided to incorporate the consensus from Draft Interpretation D-34 as part of those amendments. In June 2002 the IASB published an exposure draft of amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* that incorporated the proposed consensus from Draft Interpretation D-34.

BC4 In their responses to the Exposure Draft and in their participation in public round-table discussions held in March 2003, representatives of co-operative banks raised questions about the application of the principles in IAS 32 to members' shares. This was followed by a series of meetings between IASB members and staff and representatives of the European Association of Co-operative Banks. After considering questions raised by the bank group, the IASB concluded that the principles articulated in IAS 32 should not be modified, but that there were questions about the application of those principles to co-operative entities that should be considered by the IFRIC.

BC5 In considering the application of IAS 32 to co-operative entities, the IFRIC recognised that a variety of entities operate as co-operatives and these entities have a variety of capital structures. The IFRIC decided that its proposed Interpretation should address some features that exist in a number of co-operatives. However, the IFRIC noted that its conclusions and the examples in the Interpretation are not limited to the specific characteristics of members' shares in European co-operative banks.

Basis for consensus

BC6 Paragraph 15 of IAS 32 states:

> 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. [Emphasis added]

BC7 In many jurisdictions, local law or regulations state that members' shares are equity of the entity. However, paragraph 17 of IAS 32 states:

> 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. [Emphasis added]

BC8 Paragraphs cited in the examples in the Appendix and in the paragraphs above show that, under IAS 32, the terms of the contractual agreement govern the classification of a financial instrument as a financial liability or equity. If the terms of an instrument create an unconditional obligation to transfer cash or another financial asset, circumstances that might restrict an entity's ability to make the transfer when due do not alter the classification as a financial liability. If the terms of the instrument give the entity an unconditional right to avoid delivering cash or another financial asset, the instrument is classified as equity. This is true even if other factors make it likely that the entity will continue to distribute dividends or make or other payments. In view of those principles, the IFRIC decided to focus on circumstances that would indicate that the entity has the unconditional right to avoid making payments to a member who has requested that his or her shares be redeemed.

BC9 The IFRIC identified two situations in which a co-operative entity has an unconditional right to avoid the transfer of cash or another financial asset. The IFRIC acknowledges that there may be other situations that may raise questions about the application of IAS 32 to members' shares. However, it understands that the two situations are often present in the contractual and other conditions surrounding members' shares and that interpretation of those two situations would eliminate many of the questions that may arise in practice.

BC10 The IFRIC also noted that an entity assesses whether it has an unconditional right to avoid the transfer of cash or another financial asset on the basis of local laws, regulations and its governing charter in effect at the date of classification. This is because it is local laws, regulations and the governing charter in effect at the classification date, together with the terms contained in the instrument's documentation that constitute the terms and conditions of the instrument at that date. Accordingly, an entity does not take into account expected future amendments to local law, regulation or its governing charter.

The right to refuse redemption (paragraph 7)

BC11 An entity may have the unconditional right to refuse redemption of a member's shares. If such a right exists, the entity does not have the obligation to transfer cash or another financial asset that IAS 32 identifies as a critical characteristic of a financial liability.

BC12 The IFRIC considered whether the entity's history of making redemptions should be considered in deciding whether the entity's right to refuse requests is, in fact, unconditional. The IFRIC observed that a history of making redemptions may create a reasonable expectation that all future requests will be honoured. However, holders of many equity instruments have a reasonable expectation that an entity will continue a past practice of making payments. For example, an entity may have made dividend payments on preference shares for decades. Failure to make those payments would expose the entity to significant economic costs, including damage to the value of its ordinary shares. Nevertheless, as outlined in IAS 32 paragraph AG26 (cited in paragraph A3), a holder's expectations about dividends do not cause a preferred share to be classified as a financial liability.

Prohibitions against redemption (paragraphs 8 and 9)

BC13 An entity may be prohibited by law or its governing charter from redeeming members' shares if doing so would cause the number of members' shares, or the amount of paid-in capital from members' shares, to fall below a specified level. While each individual share might be puttable, a portion of the total shares outstanding is not.

BC14 The IFRIC concluded that conditions limiting an entity's ability to redeem members' shares must be evaluated sequentially. Unconditional prohibitions like those noted in paragraph 8 of the consensus prevent the entity from *incurring a liability* for redemption of all or some of the members' shares, regardless of whether it would otherwise be able to satisfy that financial liability. This contrasts with conditional prohibitions that prevent payments being made only if specified conditions—such as liquidity constraints—are met. Unconditional prohibitions prevent a liability from coming into existence, whereas the conditional prohibitions may only defer the payment of a liability already incurred. Following this analysis, an unconditional prohibition affects classification when an instrument subject to the prohibition is issued or when the prohibition is enacted or added to the entity's governing charter. In contrast, conditional restrictions such as those described in paragraphs 19 and AG25 of IAS 32 do not result in equity classification.

BC15 The IFRIC discussed whether the requirements in IAS 32 can be applied to the classification of members' shares as a whole subject to a partial redemption prohibition. IAS 32 refers to 'a financial instrument', 'a financial liability' and 'an equity instrument'. It does not refer to groups or portfolios of instruments. In view of this the IFRIC considered whether it could apply the requirements in IAS 32 to the classification of members' shares subject to partial redemption prohibitions. The application of IAS 32 to a prohibition against redeeming some portion of members' shares (eg 500,000 shares of an entity with 1,000,000 shares outstanding) is unclear.

BC16 The IFRIC noted that classifying a group of members' shares using the individual instrument approach could lead to misapplication of the principle of 'substance of the contract' in IAS 32. The IFRIC also noted that paragraph 23 of IAS 32 requires an entity that has entered into an agreement to purchase its own equity instruments to recognise a financial liability for the present value of the redemption amount (eg for the present value of the forward repurchase price, option exercise price or other redemption amount) even though the shares subject to the repurchase agreement are not individually identified. Accordingly, the IFRIC decided that for purposes of classification there are instances when IAS 32 does not require the individual instrument approach.

BC17 In many situations, looking at either individual instruments or all of the instruments governed by a particular contract would result in the same classification as financial liability or equity under IAS 32. Thus, if an entity is prohibited from redeeming any of its members' shares, the shares are not puttable and are equity. On the other hand, if there is no prohibition on redemption and no other conditions apply, members' shares are puttable and the shares are financial liabilities. However, in the case of partial prohibitions against redemption, the classification of members' shares governed by the same charter will differ, depending on whether such a classification is based on individual members' shares or the group of members' shares as a whole. For example, consider an entity with a partial prohibition that prevents it from redeeming 99 per cent of the highest number of members' shares ever outstanding. The classification based on individual shares considers each share to be potentially puttable and therefore a financial liability. This is different from the classification based on all of the members' shares. While each member's share may be redeemable individually, 99 per cent of the highest number of shares ever outstanding is not redeemable in any circumstances other than liquidation of the entity and therefore is equity.

Measurement on initial recognition (paragraph 10)

BC18 The IFRIC noted that when the financial liability for the redemption of members' shares that are redeemable on demand is initially recognised, the financial liability is measured at fair value in accordance with paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement.* Paragraph 49 states: 'The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid'. Accordingly, the IFRIC decided that the fair value of the financial liability for redemption of members' shares redeemable on demand is the maximum amount payable under the redemption provisions of its governing charter or applicable law. The IFRIC also considered situations in which the number of members' shares or the amount of paid-in capital subject to prohibition against redemption may change. The IFRIC concluded that a change in the level of a prohibition against redemption should lead to a transfer between financial liabilities and equity.

Subsequent measurement

BC19 Some respondents requested additional guidance on subsequent measurement of the liability for redemption of members' shares. The IFRIC noted that the focus of this Interpretation was on clarifying the classification of financial instruments rather than their subsequent measurement. Also, the IASB has on its agenda a project to address the accounting for financial instruments (including members' shares) that are redeemable at a pro rata share of the fair value of the residual interest in the entity issuing the financial instrument. The IASB will consider certain measurement issues in this project. The IFRIC was also informed that the majority of members' shares in co-operative entities are not redeemable at a pro rata share of the fair value of the residual interest in the co-operative entity thereby obviating the more complex measurement issues. In view of the above, the IFRIC decided not to provide additional guidance on measurement in the Interpretation.

Presentation

BC20 The IFRIC noted that entities whose members' shares are not equity could use the presentation formats included in paragraphs IE32 and IE33 of the Illustrative Examples with IAS 32.

Alternatives considered

BC21 The IFRIC considered suggestions that:

(a) members' shares should be classified as equity until a member has requested redemption. That member's share would then be classified as a financial liability and this treatment would be consistent with local laws. Some commentators believe this is a more straightforward approach to classification.

(b) the classification of members' shares should incorporate the probability that members will request redemption. Those who suggest this view observe that experience shows this probability to be small, usually within 1-5 per cent, for some types of co-operative. They see no basis for classifying 100 per cent of the members' shares as liabilities on the basis of the behaviour of 1 per cent.

BC22 The IFRIC did not accept those views. Under IAS 32, the classification of an instrument as financial liability or equity is based on the 'substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.' In paragraph BC7 of the Basis for Conclusions on IAS 32, the IASB observed:

> 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.

BC23 The IFRIC also observed that an approach similar to that in paragraph BC21(a) is advocated in the Dissenting Opinion of one Board member on IAS 32. As the IASB did not adopt that approach its adoption here would require an amendment to IAS 32.

Transition and effective date (paragraph 14)

BC24 The IFRIC considered whether its Interpretation should have the same transition and effective date as IAS 32, or whether a later effective date should apply with an exemption from IAS 32 for members' shares in the interim. Some co-operatives may wish to amend their governing charter in order to continue their existing practice under national accounting requirements of classifying members' shares as equity. Such amendments usually require a general meeting of members and holding a meeting may not be possible before the effective date of IAS 32.

BC25 After considering a number of alternatives, the IFRIC decided against any exemption from the transition requirements and effective date in IAS 32. In reaching this conclusion, the IFRIC noted that it was requested to provide guidance on the application of IAS 32 when it is first adopted by co-operative entities, ie from 1 January 2005. Also, the vast majority of those who commented on the draft Interpretation did not object to the proposed effective date of 1 January 2005. Finally, the IFRIC observed that classifying members' shares as financial liabilities before the date that the terms of these shares are amended will affect only 2005 financial statements, as first-time adopters are not required to apply IAS 32 to earlier periods. As a result, any effect of the Interpretation on first-time adopters is expected to be limited. Furthermore, the IFRIC noted that regulators are familiar with the accounting issues involved. A co-operative entity may be required to present members' shares as a liability until the governing charter is amended. The IFRIC understands that such amendments, if adopted, could be in place by mid-2005. Accordingly, the IFRIC decided that the effective date for the Interpretation would be annual periods beginning on or after 1 January 2005.

HK(IFRIC)-Int 4
Revised ~~July 2012~~February 2014

Effective for annual periods
beginning on or after 1 January 2006

HK(IFRIC) Interpretation 4

Determining whether an Arrangement contains a Lease

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CONTENTS

HK(IFRIC) Interpretation 4 *Determining whether an Arrangement contains a Lease* (HK(IFRIC)-Int 4) is set out in paragraphs 1-17 and the Appendix. HK(IFRIC)-Int 4 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*.

HK(IFRIC)-Int 4
Determining whether an Arrangement contains a Lease

References[ϕ]

- HKFRS 13 *Fair Value Measurement*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 17 *Leases*
- HKAS 38 *Intangible Assets*
- HK(IFRIC) - Int 12 *Service Concession Arrangements*

Background

1 An entity may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset (eg an item of property, plant or equipment) in return for a payment or series of payments. Examples of arrangements in which one entity (the supplier) may convey such a right to use an asset to another entity (the purchaser), often together with related services, include:

- outsourcing arrangements (eg the outsourcing of the data processing functions of an entity).
- arrangements in the telecommunications industry, in which suppliers of network capacity enter into contracts to provide purchasers with rights to capacity.
- take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (eg a take-or-pay contract to acquire substantially all of the output of a supplier's power generator).

2 This Interpretation provides guidance for determining whether such arrangements are, or contain, leases that should be accounted for in accordance with HKAS 17. It does not provide guidance for determining how such a lease should be classified under that Standard.

3 In some arrangements, the underlying asset that is the subject of the lease is a portion of a larger asset. This Interpretation does not address how to determine when a portion of a larger asset is itself the underlying asset for the purposes of applying HKAS 17. Nevertheless, arrangements in which the underlying asset would represent a unit of account in either HKAS 16 or HKAS 38 are within the scope of this Interpretation.

Scope

4 This Interpretation does not apply to arrangements that:

(a) are, or contain, leases excluded from the scope of HKAS 17; or

(b) are public-to-private service concession arrangements within the scope of HK(IFRIC)-Int 12.

ϕ With effect from 1 January 2005, all the existing Statements of Standard Accounting Practice (SSAPs) and Interpretations for which there are equivalent International Accounting Standards (IAS) and SIC Interpretations will be renamed as Hong Kong Accounting Standards (HKASs) and Hong Kong (SIC) Interpretations (HK(SIC)-Int) with numbers corresponding to the equivalent IAS and SIC Interpretations, respectively. For full details of this change, please click on the following link: http://www.hkicpa.org.hk/professionaltechnical/accounting/rm/memorandum.pdf. If an entity applies this Interpretation for a period beginning before 1 January 2005, the entity shall follow the requirements of SSAPs effective for that period, unless the entity is applying the relevant HKASs for that earlier period. Accordingly, references to the HKASs in this Interpretation should be read as references to the related superseded SSAPs as recorded in the table of concordance set out in the HKICPA website: http://www.hkicpa.org.hk/professionaltechnical/accounting/dueprocess/concordance.pdf, where appropriate.

15 If a purchaser concludes that it is impracticable to separate the payments reliably, it shall:

(a) in the case of a finance lease, recognise an asset and a liability at an amount equal to the fair value[1] of the underlying asset that was identified in paragraphs 7 and 8 as the subject of the lease. Subsequently the liability shall be reduced as payments are made and an imputed finance charge on the liability recognised using the purchaser's incremental borrowing rate of interest.[2]

(b) in the case of an operating lease, treat all payments under the arrangement as lease payments for the purposes of complying with the disclosure requirements of HKAS 17, but

(i) disclose those payments separately from minimum lease payments of other arrangements that do not include payments for non-lease elements, and

(ii) state that the disclosed payments also include payments for non-lease elements in the arrangement.

Effective date

16 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies this Interpretation for a period beginning before 1 January 2006, it shall disclose that fact.

16A An entity shall apply the amendment in paragraph 4(b) for annual periods beginning on or after 1 January 2008. If an entity applies HK(IFRIC)-Int 12 for an earlier period, the amendment shall be applied for that earlier period.

Transition

17. HKAS 8 specifies how an entity applies a change in accounting policy resulting from the initial application of an Interpretation. An entity is not required to comply with those requirements when first applying the Interpretation. If an entity uses this exemption, it shall apply paragraphs 6-9 of this Interpretation to arrangements existing at the start of the earliest period for which comparative information under HKFRSs is presented on the basis of facts and circumstances existing at the start of that period.

[1] HKAS 17 uses the term 'fair value' in a way that differs in some respects from the definition of fair value in HKFRS 13. Therefore, when applying HKAS 17 an entity measures fair value in accordance with HKAS 17, not HKFRS 13.

[2] ie the lessee's incremental borrowing rate of interest as defined in paragraph 4 of HKAS 17.

BC14 The IFRIC considered whether the scope of the Interpretation might overlap with IAS 39 *Financial Instruments: Recognition and Measurement.* In particular it noted the view that an arrangement for output might meet the definition of a derivative under IAS 39 but also be determined to contain a lease under this Interpretation. The IFRIC concluded that there should not be an overlap because an arrangement for output that is a derivative would not meet the criteria in paragraphs 6-9 of the Interpretation. In particular, the IFRIC noted that such an arrangement would be for a product with a quoted market price available in an active market and would therefore be unlikely to depend upon the use of a specifically identified asset.

BC14A The IFRIC considered whether the scope of the Interpretation might overlap with IFRIC 12, which was developed from draft Interpretations D12-D14. In particular it noted the views expressed by some respondents to the proposals that the contractual terms of some public-to-private service concession arrangements would be regarded as leases under IFRIC 4 and would also be regarded as meeting the scope criterion of D12-D14. The IFRIC did not regard the choice between accounting treatments as appropriate because it could lead to different accounting treatments for contracts that have similar economic effects. The IFRIC therefore amended IFRIC 4 to specify that if a public-to-private service concession arrangement met the scope requirements of IFRIC 12 it would not be within the scope of IFRIC 4.

Consensus (paragraphs 6-15)

Criteria for determining whether an arrangement contains a lease (paragraphs 6-9)

BC15 In D3 the IFRIC proposed that three criteria would all need to be satisfied for an arrangement to be, or contain, a lease:

(a) The arrangement depends upon a specific item or items (the item). The item need not be explicitly identified by the contractual provisions of the arrangement. Rather it may be implicitly identified because it is not economically feasible or practical for the supplier to fulfil the arrangement by providing use of alternative items.

(b) The arrangement conveys a right to use the item for a specific period of time such that the purchaser is able to exclude others from using the item.

(c) Payments under the arrangement are made for the time that the item is made available for use rather than for actual use of the item.

BC16 D3 also proposed that arrangements in which there is only a remote possibility that parties other than the purchaser will take more than an insignificant amount of the output produced by an item would meet the second of the criteria above.

BC17 In its Basis for Conclusions on D3, the IFRIC drew attention to the similarities between its Interpretation and Issue No. 01-8 *Determining Whether an Arrangement Contains a Lease* published by the US Emerging Issues Task Force (EITF) in May 2003. The IFRIC concluded that '[a]lthough the wording of Issue 01-8 and the draft Interpretation differ, …a similar assessment of whether an arrangement contains a lease is likely under both interpretations.'

BC18 Some respondents disagreed with the IFRIC's conclusion and suggested that the differences between the two interpretations were, in fact, significant. The IFRIC, however, maintained its original conclusion. In particular, it noted that both it and the EITF had concluded that a right of use can be conveyed in arrangements in which purchasers have rights to acquire the output that will be produced by an asset, regardless of any right or ability physically to operate or control access to that asset. Accordingly, many take-or-pay (and similar contracts) would have been similarly assessed under the two interpretations.

BC19 Nonetheless, the IFRIC agreed that some arrangements would be regarded as leases under Issue 01-8 but not under D3. The IFRIC concluded that there were two main reasons for this. First, the effect of the third criterion in D3 ('payments under the arrangement are made for the time that the item is made available for use rather than for actual use of the item') was that a purchaser would always be required to assume some pricing risk in an arrangement for there to be a lease. This is not the case under Issue 01-8. Secondly, the second criterion in D3 ('the arrangement conveys a right to use the item …such that the purchaser is able to exclude others from using the item') suggested that a right of use is conveyed in an arrangement for the output from an asset only when the purchaser is taking *substantially all* of the output from a specific asset. Under Issue 01-8, a right of use is also conveyed if the purchaser controls or operates the underlying specific asset while taking more than a *minor amount* of the output from an asset.

BC20 The IFRIC noted that the definition of a lease in IAS 17 is similar to its definition in the US standard SFAS 13 *Accounting for Leases*. Given this, the IFRIC concluded that there was no compelling reason for different assessments of whether an arrangement contains a lease under IFRSs and US GAAP. Furthermore, the IFRIC was sympathetic to the practical difficulties highlighted by some respondents that would arise in cases when an agreement would need to be assessed against two similar, but different, sets of criteria. Therefore, the IFRIC decided that it should seek to eliminate the differences between the approach in D3 and Issue 01-8 for determining whether an arrangement contains a lease. The IFRIC concluded that the most effective way of achieving this objective would be to modify its criteria to conform them more fully to the approach in Issue 01-8.

BC21 The IFRIC decided that as far as possible it should adopt the actual words from Issue 01-8, subject to differences between IAS 17 and SFAS 13. It concluded that differences in wording would not promote convergence and would be likely to cause confusion. Therefore, paragraphs 7-9 are virtually identical to Issue 01-8, except that:

(a) the Interpretation uses the term 'asset' rather than 'property, plant or equipment' as in Issue 01-8. The IFRIC noted that IAS 17 covers a broader range of leases than SFAS 13 and that there was no reason for restricting this Interpretation only to items of property, plant or equipment.

(b) the phrase 'more than a minor amount of the output' in Issue 01-8 has been expressed as 'more than an insignificant amount of the output'. This is because the latter is the more customary form of words under IFRSs and is therefore consistent with other Standards. In this context, however, the IFRIC intends 'minor' and 'insignificant' to have the same meaning.

BC22 Apart from small modifications to the wording of the first criterion in D3, the effect of converging fully with the criteria in Issue 01-8 for determining whether an arrangement contains a lease is that the second and third criteria in D3 are replaced by one criterion, requiring the arrangement to convey to the purchaser the right to control the use of the underlying asset.

BC23 Although the requirements for determining whether an arrangement contains a lease are the same under IFRSs and US GAAP, the IFRIC emphasises that any lease identified by the Interpretation may be accounted for differently under IFRSs and US GAAP because of differences between their respective leasing standards.

Fulfilment of the arrangement is dependent on the use of a specific asset (paragraphs 7 and 8)

BC24 The IFRIC agreed that a specific asset needs to be identified in the arrangement for there to be a lease. The IFRIC concluded that this follows from the definition of a lease, which refers to a 'right to use *an* asset' (emphasis added). The IFRIC also observed that dependence on a specifically identified asset is a feature that distinguishes a lease from other arrangements that also convey rights to use assets but are not leases (eg some service arrangements).

BC25 However, the IFRIC concluded that the identification of the asset in the arrangement need not be explicit. Rather, the facts and circumstances could implicitly identify an asset because it would not be economically feasible or practical for the supplier to perform its obligation by providing the use of alternative assets. Examples of when an asset may be implicitly identified are when the supplier owns only one suitable asset; the asset used to fulfil the contract needs to be at a particular location or specialised to the purchaser's needs; and the supplier is a special purpose entity formed for a limited purpose.[*]

[*] SIC-12 *Consolidation – Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

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HK(IFRIC) Interpretation 5

Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

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

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HK(IFRIC) INTERPRETATION 5

RIGHTS TO INTERESTS ARISING FROM DECOMMISSIONING,RESTORATION AND ENVIRONMENTAL REHABILITATION FUNDS

HK(IFRIC) Interpretation 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (HK(IFRIC)-Int 5) is set out in paragraphs 1-15 and the Appendix. HK(IFRC)-Int 5 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 5
Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

References[ϕ]

- HKFRS 10 *Consolidated Financial Statements*
- HKFRS 11 *Joint Arrangements*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- ~~HKAS 27 *Consolidated and Separate Financial Statements*~~
- HKAS 28 *Investments in Associates and Joint Ventures*
- ~~HKAS 31 *Interests in Joint Ventures*~~
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- HKAS 39 *Financial Instruments: Recognition and Measurement*
- ~~HK(SIC) - Int 12 *Consolidation – Special Purpose Entities*~~

Background

1 The purpose of decommissioning, restoration and environmental rehabilitation funds, hereafter referred to as 'decommissioning funds' or 'funds', is to segregate assets to fund some or all of the costs of decommissioning plant (such as a nuclear plant) or certain equipment (such as cars), or in undertaking environmental rehabilitation (such as rectifying pollution of water or restoring mined land), together referred to as 'decommissioning'.

2 Contributions to these funds may be voluntary or required by regulation or law. The funds may have one of the following structures:

(a) funds that are established by a single contributor to fund its own decommissioning obligations, whether for a particular site, or for a number of geographically dispersed sites.

(b) funds that are established with multiple contributors to fund their individual or joint decommissioning obligations, when contributors are entitled to reimbursement for decommissioning expenses to the extent of their contributions plus any actual earnings on those contributions less their share of the costs of administering the fund. Contributors may have an obligation to make additional contributions, for example, in the event of the bankruptcy of another contributor.

(c) funds that are established with multiple contributors to fund their individual or joint decommissioning obligations when the required level of contributions is based on the current activity of a contributor and the benefit obtained by that contributor is based on its past activity. In such cases there is a potential mismatch in the amount of contributions made by a contributor (based on current activity) and the value realisable from the fund (based on past activity).

[ϕ] With effect from 1 January 2005, all the existing Statements of Standard Accounting Practice (SSAPs) and Interpretations for which there are equivalent International Accounting Standards (IAS) and SIC Interpretations will be renamed as Hong Kong Accounting Standards (HKASs) and Hong Kong (SIC) Interpretations (HKAS(SIC)-Int) with numbers corresponding to the equivalent IAS and SIC Interpretations, respectively. For full details of this change, please click on the following link: http://www.hkicpa.org.hk/professionaltechnical/accounting/rm/memorandum.pdf. If an entity applies this Interpretation for a period beginning before 1 January 2005, the entity shall follow the requirements of SSAPs effective for that period, unless the entity is applying the relevant HKASs for that earlier period. Accordingly, references to the HKASs or HKAS-Int in this Interpretation should be read as references to the related superseded SSAPs as recorded in the table of concordance set out in the HKICPA website: http://www.hkicpa.org.hk/professionaltechnical/accounting/dueprocess/concordance.pdf, where appropriate.

3 Such funds generally have the following features:

(a) the fund is separately administered by independent trustees.

(b) entities (contributors) make contributions to the fund, which are invested in a range of assets that may include both debt and equity investments, and are available to help pay the contributors' decommissioning costs. The trustees determine how contributions are invested, within the constraints set by the fund's governing documents and any applicable legislation or other regulations.

(c) the contributors retain the obligation to pay decommissioning costs. However, contributors are able to obtain reimbursement of decommissioning costs from the fund up to the lower of the decommissioning costs incurred and the contributor's share of assets of the fund.

(d) the contributors may have restricted access or no access to any surplus of assets of the fund over those used to meet eligible decommissioning costs.

Scope

4 This Interpretation applies to accounting in the financial statements of a contributor for interests arising from decommissioning funds that have both of the following features:

(a) the assets are administered separately (either by being held in a separate legal entity or as segregated assets within another entity); and

(b) a contributor's right to access the assets is restricted.

5 A residual interest in a fund that extends beyond a right to reimbursement, such as a contractual right to distributions once all the decommissioning has been completed or on winding up the fund, may be an equity instrument within the scope of HKAS 39 and is not within the scope of this Interpretation.

Issues

6 The issues addressed in this Interpretation are:

(a) how should a contributor account for its interest in a fund?

(b) when a contributor has an obligation to make additional contributions, for example, in the event of the bankruptcy of another contributor, how should that obligation be accounted for?

Conclusions

Accounting for an interest in a fund

7 The contributor shall recognise its obligation to pay decommissioning costs as a liability and recognise its interest in the fund separately unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay.

8 The contributor shall determine whether it has control~~,~~ or joint control of, or significant influence over, the fund by reference to ~~HKAS 27,~~HKFRS 10, HKFRS 11 and HKAS 28~~, HKAS 31 and HK(SIC) Int 12~~. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.

9 If a contributor does not have control~~,~~ or joint control of, or significant influence over, the fund, the contributor shall recognise the right to receive reimbursement from the fund as a reimbursement in accordance with HKAS 37. This reimbursement shall be measured at the lower of:

(a) the amount of the decommissioning obligation recognised; and

(b) the contributor's share of the fair value of the net assets of the fund attributable to contributors.

Changes in the carrying value of the right to receive reimbursement other than contributions to and payments from the fund shall be recognised in profit or loss in the period in which these changes occur.

Accounting for obligations to make additional contributions

10 When a contributor has an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor or if the value of the investment assets held by the fund decreases to an extent that they are insufficient to fulfil the fund's reimbursement obligations, this obligation is a contingent liability that is within the scope of HKAS 37. The contributor shall recognise a liability only if it is probable that additional contributions will be made.

Disclosure

11 A contributor shall disclose the nature of its interest in a fund and any restrictions on access to the assets in the fund.

12 When a contributor has an obligation to make potential additional contributions that is not recognised as a liability (see paragraph 10), it shall make the disclosures required by paragraph 86 of HKAS 37.

13 When a contributor accounts for its interest in the fund in accordance with paragraph 9, it shall make the disclosures required by paragraph 85(c) of HKAS 37.

Effective date

14 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies this Interpretation to a period beginning before 1 January 2006, it shall disclose that fact.

14A *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

14B HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraphs 8 and 9. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

Transition

15 Changes in accounting policies shall be accounted for in accordance with the requirements of HKAS 8.

Appendix

Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement*

The amendment in this appendix shall be applied for annual periods beginning on or after 1 January 2006. If an entity applies this Interpretation for an earlier period, the amendment shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Interpretation was issued have been incorporated into the relevant Standards.

Basis for Conclusions on IFRIC Interpretation 5

This Basis for Conclusions accompanies, but is not part of, IFRIC 5.

The original text has been marked up to reflect the revision of HKAS 1 Presentation of Financial Statements *in 2007; new text is underlined and deleted text is struck through.*

HK(IFRIC) Interpretation 5 is based on IFRIC Interpretation 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*. In approving HK(IFRIC) Interpretation 5, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 5. Accordingly, there are no significant differences between HK(IFRIC) Interpretation 5 and IFRIC Interpretation 5. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 5 referred to below generally correspond with those in HK(IFRIC) Interpretation 5.

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.

Background (paragraphs 1-3)

BC2 The IFRIC was informed that an increasing number of entities with decommissioning obligations are contributing to a separate fund established to help fund those obligations. The IFRIC was also informed that questions have arisen in practice over the accounting treatment of interests in such funds and that there is a risk that divergent practices may develop. The IFRIC therefore concluded that it should provide guidance to assist in answering the questions in paragraph 6, in particular on the accounting for the asset of the right to receive reimbursement from a fund. On the issue of whether the fund should be consolidated or equity accounted, the IFRIC concluded that the normal requirements of IAS 27 *Consolidated and Separate Financial Statements*, SIC-12 *Consolidation–Special Purpose Entities*, IAS 28 *Investments in Associates*[1] or IAS 31 *Interests in Joint Ventures*[2] apply and that there is no need for interpretative guidance[3]. The IFRIC published its proposed Interpretation on 15 January 2004 as D4 *Decommissioning, Restoration and Environmental Rehabilitation Funds.*

BC3 Paragraphs 1-3 describe ways in which entities might arrange to fund their decommissioning obligations. Those that are within the scope of the Interpretation are specified in paragraphs 4-6.

Scope (paragraphs 4 and 5)

BC4 D4 did not precisely define the scope because the IFRIC believed that the large variety of schemes in operation would make any definition inappropriate. However, some respondents to D4 disagreed and commented that the absence of any definition made it unclear when the Interpretation should be applied. As a result, the IFRIC has specified the scope by identifying the features that make an arrangement a decommissioning fund. It has also described the different types of fund and the features that may (or may not) be present.

BC5 The IFRIC considered whether it should issue a wider Interpretation that addresses similar forms of reimbursement, or whether it should prohibit the application of the Interpretation to other situations by analogy. The IFRIC rejected any widening of the scope, deciding instead to concentrate on the matter referred to it. The IFRIC also decided that there was no reason to prohibit the application of the Interpretation to other situations by analogy and thus the hierarchy of criteria in paragraphs 7-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* would apply, resulting in similar accounting for reimbursements under arrangements that are not decommissioning funds, but have similar features.

BC6 The IFRIC considered comments from respondents that a contributor may have an interest in the fund that extends beyond its right to reimbursement. In response, the IFRIC added clarification that a residual interest in a fund, such as a contractual right to distributions once all the decommissioning has been completed or on winding up the fund, may be an equity instrument within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*.

[1] In May 2011, the Board amended IAS 28 and changed its title to *Investments in Associates and Joint Ventures*.

[2] IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31.

[3] The consolidation requirements in IAS 27 and SIC-12 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011.

Basis for consensus

Accounting for an interest in a fund (paragraphs 7-9)

BC7 The IFRIC concluded that the contributor should recognise a liability unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay. This is because the contributor remains liable for the decommissioning costs. Additionally, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides that:

(a) when an entity remains liable for expenditure, a provision should be recognised even where reimbursement is available; and

(b) if the reimbursement is virtually certain to be received when the obligation is settled, then it should be treated as a separate asset.

BC8 In concluding that the contributor should recognise separately its liability to pay decommissioning costs and its interest in the fund, the IFRIC also noted the following:

(a) There is no legally enforceable right to set off the rights under the decommissioning fund against the decommissioning liabilities. Also, given that the main objective is reimbursement, it is likely that settlement will not be net or simultaneous. Accordingly, treating these rights and liabilities as analogous to financial assets and financial liabilities would not result in offset because the offset criteria in IAS 32 *Financial Instruments: Disclosure and Presentation*[4] are not met.

(b) Treating the decommissioning obligation as analogous to a financial liability would not result in derecognition through extinguishment. If the fund does not assume the obligation for decommissioning, the criteria in IAS 39 for derecognition of financial liabilities through extinguishment are not met. At best, the fund acts like an in-substance defeasance that does not qualify for derecognition of the liability.

(c) It would not be appropriate to treat decommissioning funds as analogous to pension funds, which are presented net of the related liability. This is because, in allowing a net presentation for pension plans in IAS 19 *Employee Benefits,* the International Accounting Standards Board's predecessor organisation, IASC, stated that it believed the situation is 'unique to employee benefit plans and [it did] not intend to permit this net presentation for other liabilities if the conditions in IAS 32 and IAS 39 are not met' (IAS 19, Basis for Conclusions paragraph 68I)[5].

BC9 As to the accounting for the contributor's interest in the fund, the IFRIC noted that some interests in funds would be within the scope of IAS 27, IAS 28, IAS 31[6] or SIC-12. As noted in paragraph BC2, the IFRIC concluded that, in such cases, the normal requirements of those Standards would apply and there is no need for interpretative guidance.

BC10 Otherwise, the IFRIC concluded that the contributor has an asset for its right to receive amounts from the fund.

The right to receive reimbursement from a fund and amendment to the scope of IAS 39

BC11 The IFRIC noted that under existing IFRSs, there are two forms of rights to reimbursement that would be accounted for differently:

(a) A contractual right to receive reimbursement in the form of cash. This meets the definition of a financial asset and is within the scope of IAS 39. Such a financial asset would be classified as an available-for-sale financial asset (unless accounted for using the fair value option) because it does not meet the definitions of a financial asset held for trading, a held-to-maturity investment or a loan or receivable.[7]

[4] In August 2005, IAS 32 has amended as IAS 32 *Financial Instruments*: *Presentation.*
[5] Paragraph BC68I was renumbered as paragraph BC186 when IAS 19 was amended in 2011.
[6] IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31.
[7] An interest in a decommissioning fund would not meet the definition of held for trading because it is not acquired or incurred principally for the purpose of selling or repurchasing it in the near term, nor of a held-to-maturity investment because it does not have fixed or determinable maturity. In addition, an interest in a fund is excluded from the definition of loans and receivables in IAS 39 since it is 'an interest acquired in a pool of assets that are not loans and receivables'.

(b) A right to reimbursement other than a contractual right to receive cash. This does not meet the definition of a financial asset and is within the scope of IAS 37.

BC12 The IFRIC concluded that both these forms of reimbursement have economically identical effects. Therefore accounting for both forms in the same way would provide relevant and reliable information to a user of the financial statements. However, the IFRIC noted that this did not appear possible under existing IFRSs because some such rights are within the scope of IAS 39, and others are not. Therefore, it asked the Board to amend the scope of IAS 39 to exclude rights to reimbursement for expenditure required to settle:

(a) a provision that has been recognised in accordance with IAS 37; and

(b) obligations that had been originally recognised as provisions in accordance with IAS 37, but are no longer provisions because their timing or amount is no longer uncertain. An example of such a liability is one that was originally recognised as a provision because of uncertainty about the timing of the cash outflow, but subsequently becomes another type of liability because the timing is now certain.

BC13 This amendment was approved by the Board and is set out in the Appendix of IFRIC 5[8]. As a result, all such rights to reimbursement are within the scope of IAS 37.

BC14 The IFRIC noted that paragraph 53 of IAS 37 specifies the accounting for rights to receive reimbursement. It requires this right to reimbursement to be separately recognised when it is virtually certain that reimbursement will be received if the contributor settles the obligation. The IFRIC also noted that this paragraph prohibits the recognition of an asset in excess of the recognised liability. For example, rights to receive reimbursement to meet decommissioning liabilities that have yet to be recognised as a provision are not recognised. Accordingly, the IFRIC concluded that when the right to reimbursement is virtually certain to be received if the contributor settles its decommissioning obligation, it should be measured at the lower of the amount of the decommissioning obligation recognised and the reimbursement right.

BC15 The IFRIC discussed whether the reimbursement right should be measured at:

(a) the contributor's share of the fair value of the net assets of the fund attributable to contributors, taking into account any inability to access any surplus of the assets of the fund over eligible decommissioning costs (with any obligation to make good potential defaults of other contributors being treated separately as a contingent liability); or

(b) the fair value of the reimbursement right (which would normally be lower than (a) because of the risks involved, such as the possibility that the contributor may be required to make good defaults of other contributors).

BC16 The IFRIC noted that the right to reimbursement relates to a decommissioning obligation for which a provision would be recognised and measured in accordance with IAS 37. Paragraph 36 of IAS 37 requires such provisions to be measured at 'the best estimate of the expenditure required to settle the present obligation at the ~~balance sheet date~~end of the reporting period'. The IFRIC noted that the amount in paragraph BC15(a)—ie the contributor's share of the fair value of the net assets of the fund attributable to contributors, taking into account any inability to access any surplus of the assets of the fund over eligible decommissioning costs—is the best estimate of the amount available to the contributor to reimburse it for expenditure it had incurred to pay for decommissioning. Thus, the amount of the asset recognised would be consistent with the amount of the liability recognised.

BC17 In contrast, the IFRIC noted that the amount in paragraph BC15(b)—ie the fair value of the reimbursement right—would take into account the factors such as liquidity that the IFRIC believed to be difficult to measure reliably. Furthermore, this amount would be lower than that in paragraph BC15(a) because it reflects the possibility that the contributor may be required to make potential additional contributions in the event of default by other contributors. The IFRIC noted that its decision that the obligation to make potential additional contributions should be treated as a contingent liability in accordance with IAS 37 (see paragraphs BC22-BC25) would result in double-counting of the risk of the additional contribution being required if the measure in paragraph BC15(b) were to be used.

BC18 Consequently, the IFRIC concluded that the approach in paragraph BC15(a) would provide the most useful information to users.

[8] The amendment has been incorporated into the text of IAS 39 as published in this volume.

The asset cap

BC19 Many respondents to D4 expressed concern about the 'asset cap' that is imposed by the requirement in paragraph 9. This asset cap limits the amount recognised as a reimbursement asset to the amount of the decommissioning obligation recognised. These respondents argued that rights to benefit in excess of this amount give rise to an additional asset, separate from the reimbursement asset. Such an additional asset may arise in a number of ways, for example:

(a) the contributor has the right to benefit from a repayment of any surplus in the fund that exists once all the decommissioning has been completed or on winding up the fund.

(b) the contributor has the right to benefit from reduced contributions to the fund or increased benefits from the fund (eg by adding new sites to the fund for no additional contributions) in the future.

(c) the contributor expects to obtain benefit from past contributions in the future, based on the current and planned level of activity. However, because contributions are made before the decommissioning obligation is incurred, IAS 37 prevents recognition of an asset in excess of the obligation.

BC20 The IFRIC concluded that a right to benefit from a repayment of any surplus in the fund that exists once all the decommissioning has been completed or on winding up the fund may be an equity instrument within the scope of IAS 39, in which case IAS 39 would apply. However, the IFRIC agreed that an asset should not be recognised for other rights to receive reimbursement from the fund. Although the IFRIC had sympathy with the concerns expressed by constituents that there may be circumstances in which it would seem appropriate to recognise an asset in excess of the reimbursement right, it concluded that it would be inconsistent with paragraph 53 of IAS 37 (which requires that 'the amount recognised for the reimbursement should not exceed the amount of the provision') to recognise this asset. The IFRIC also noted that the circumstances in which this additional asset exists are likely to be limited, and apply only when a contributor has restricted access to a surplus of fund assets that does not give it control, joint control or significant influence over a fund. The IFRIC expects that most such assets would not meet the recognition criteria in the *Framework*[9] because they are highly uncertain and cannot be measured reliably.

BC21 The IFRIC also considered arguments that there should not be a difference between the treatment of a surplus when a fund is accounted for as a subsidiary, joint venture or associate, and when it is not. However, the IFRIC noted that, under IFRSs, restrictions on assets in subsidiaries, joint ventures or associates do not affect recognition of those assets. Hence it concluded that the difference in treatment between funds accounted for as subsidiaries, joint ventures or associates and those accounted for as a reimbursement right is inherent in IFRSs. The IFRIC also concluded that this is appropriate because, in the former case, the contributor exercises a degree of control not present in the latter case.

Obligations to make additional contributions (paragraph 10)

BC22 In some cases, a contributor has an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor.

BC23 The IFRIC noted that by 'joining' the fund, a contributor may assume the position of guarantor of the contributions of the other contributors, and hence become jointly and severally liable for the obligations of other contributors. Such an obligation is a present obligation of the contributor, but the outflow of resources associated with it may not be probable. The IFRIC noted a parallel with the example in paragraph 29 of IAS 37, which states that 'where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.' Accordingly, the IFRIC concluded that a liability would be recognised by the contributor only if it is probable that it will make additional contributions. The IFRIC noted that such a contingent liability may arise both when the contributor's interest in the fund is accounted for as a reimbursement right and when it is accounted for in accordance with IAS 27, IAS 28, IAS 31[10] or SIC-12.

[9] 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*.

[10] IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31.

BC24 The IFRIC considered the argument that an obligation to make good potential shortfalls of other contributors is a financial instrument (ie a financial guarantee) as defined in IAS 32 and hence should be accounted for in accordance with IAS 39. The grounds for this point of view are that the contributor has an obligation to deliver cash to the fund, and the fund has a right to receive cash from the contributor if a shortfall in contributions arises. However, the IFRIC noted that:

(a) a contractual obligation to make good shortfalls of other contributors is a financial guarantee. Financial guarantee contracts that provide for payments to be made if the debtor fails to make payment when due are excluded from the scope of IAS 39.

(b) when the obligation is not contractual, but rather arises as a result of regulation, it is not a financial liability as defined in IAS 32 nor is it within the scope of IAS 39.

BC25 Therefore, the IFRIC concluded that an obligation to make additional contributions in the event of specified circumstances should be treated as a contingent liability in accordance with IAS 37.

Disclosure (paragraphs 11-13)

BC26 The IFRIC noted that the contributor may not be able to access the assets of the fund (including cash or cash equivalents) for many years (eg until it undertakes the decommissioning), if ever. Therefore, the IFRIC concluded that the nature of the contributor's interest and the restriction on access should be disclosed. The IFRIC also concluded that this disclosure is equally relevant when a contributor's interest in a fund is accounted for by consolidation, proportional consolidation[11] or using the equity method because the contributor's ability to access the underlying assets may be similarly restricted.

Effective date and transition (paragraphs 14 and 15)

BC27 D4 proposed that the Interpretation should be effective for annual periods beginning on a date set at three months after the Interpretation was finalised. The IFRIC considered the view of some respondents that the Interpretation should apply from 1 January 2005 (an earlier date) on the grounds that this is the date from which many entities will adopt IFRSs, and hence adopting the Interpretation at that time would promote comparability between periods. However, the IFRIC noted its general practice is to allow at least three months between finalising an Interpretation and its application, to enable entities to obtain the Interpretation and implement any necessary systems changes. In addition, the IFRIC considered the Board's concern that the amendment to IAS 39 issued as part of the Interpretation would change the 'stable platform' of Standards that are in force for entities that will apply IFRSs for the first time in 2005. Therefore, the IFRIC decided to require that the Interpretation should be applied for annual periods beginning on or after 1 January 2006, with earlier application encouraged.

BC28 The IFRIC observed that the implementation of the Interpretation is not expected to be problematic. Therefore, the IFRIC concluded that IAS 8 should apply. Respondents to D4 did not disagree with this conclusion.

[11] IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31. IFRS 11 does not permit an entity to use 'proportionate consolidation' for accounting for interests in joint ventures.

HK(IFRIC)-Int 9
Revised ~~July 2012~~February 2014

Effective for annual periods
beginning on or after 1 June 2006

HK(IFRIC) Interpretation 9

Reassessment of Embedded Derivatives

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

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HONG KONG (IFRIC) INTERPRETATION 9
REASSESSMENT OF EMBEDDED DERIVATIVES

Hong Kong (IFRIC) Interpretation 9 *Reassessment of Embedded Derivatives* (HK(IFRIC)-Int 9) is set out in paragraphs 1-~~11~~12. HK(IFRIC)-Int 9 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 9
Reassessment of Embedded Derivatives

References

- HKAS 39 *Financial Instruments: Recognition and Measurement*
- HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*
- HKFRS 3 *Business Combinations*

Background

1 HKAS 39 paragraph 10 describes an embedded derivative as 'a component of a hybrid (combined) instrument that also includes a non-derivative host contract–with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.'

2 HKAS 39 paragraph 11 requires an embedded derivative to be separated from the host contract and accounted for as a derivative if, and only if:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated).

Scope

3 Subject to paragraphs 4 and 5 below, this Interpretation applies to all embedded derivatives within the scope of HKAS 39.

4 This Interpretation does not address remeasurement issues arising from a reassessment of embedded derivatives.

5 This Interpretation does not apply to embedded derivatives in contracts acquired in:

(a) a business combination (as defined in HKFRS 3 (as revised in 2008));

(b) a combination of entities or businesses under common control as described in paragraphs B1-B4 of HKFRS 3 (revised 2008); or

(c) the formation of a joint venture as defined in ~~HKAS 31 *Interests in Joint Ventures*~~HKFRS 11 *Joint Arrangements*

or their possible reassessment at the date of acquisition.*

* HKFRS 3 (as revised in 2008) addresses the acquisition of contracts with embedded derivatives in a business combination.

Issues

6 HKAS 39 requires an entity, when it first becomes a party to a contract, to assess whether any embedded derivatives contained in the contract are required to be separated from the host contract and accounted for as derivatives under the Standard. This Interpretation addresses the following issues:

(a) Does HKAS 39 require such an assessment to be made only when the entity first becomes a party to the contract, or should the assessment be reconsidered throughout the life of the contract?

(b) Should a first-time adopter make its assessment on the basis of the conditions that existed when the entity first became a party to the contract, or those prevailing when the entity adopts HKFRSs for the first time?

Conclusions

7 An entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is either (a) a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract or (b) a reclassification of a financial asset out of the fair value through profit or loss category, in which cases an ~~re~~assessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

7A The assessment whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of the fair value through profit or loss category in accordance with paragraph 7 shall be made on the basis of the circumstances that existed on the later date of:

(a) when the entity first became a party to the contract; and

(b) a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

For the purpose of this assessment paragraph 11(c) of HKAS 39 shall not be applied (ie the hybrid (combined) contract shall be treated as if it had not been measured at fair value with changes in fair value recognised in profit or loss). If an entity is unable to make this assessment the hybrid (combined) contract shall remain classified as at fair value through profit or loss in its entirety.

8 A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph 7.

Effective date and transition

9 An entity shall apply this Interpretation for annual periods beginning on or after 1 June 2006. Earlier application is encouraged. If an entity applies the Interpretation for a period beginning before 1 June 2006, it shall disclose that fact. The Interpretation shall be applied retrospectively.

10 *Embedded Derivatives* (Amendments to HK(IFRIC)-Int 9 and HKAS 39) issued in March 2009 amended paragraph 7 and added paragraph 7A. An entity shall apply those amendments for annual periods ending on or after 30 June 2009.

11 Paragraph 5 was amended by *Improvements to HKFRSs* issued in May 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (as revised in 2008) for an earlier period, it shall apply the amendment for that earlier period and disclose that fact.

12 HKFRS 11, issued in June 2011, amended paragraph 5(c). An entity shall apply that amendment when it applies HKFRS 11.

Basis for Conclusions on IFRIC Interpretation 9 *Reassessment of Embedded Derivatives*

This Basis for Conclusions accompanies, but is not part of, IFRIC 9.

HK(IFRIC)-Int 9 is based on IFRIC Interpretation 9 *Reassessment of Embedded Derivatives*. In approving HK(IFRIC)-Int 9, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 9. Accordingly, there are no significant differences between HK(IFRIC)-Int 9 and IFRIC Interpretation 9. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 9 referred to below generally correspond with those in HK(IFRIC)-Int 9.

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 As explained below, the IFRIC was informed that uncertainty existed over certain aspects of the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the reassessment of embedded derivatives. The IFRIC published proposals on the subject in March 2005 as D15 *Reassessment of Embedded Derivatives* and developed IFRIC 9 after considering the thirty comment letters received.

BC3 IAS 39 requires an entity, when it first becomes a party to a contract, to assess whether any embedded derivative contained in the contract needs to be separated from the host contract and accounted for as a derivative under the Standard. However, the issue arises whether IAS 39 requires an entity to continue to carry out this assessment after it first becomes a party to a contract, and if so, with what frequency. The Standard is silent on this issue and the IFRIC was informed that as a result there was a risk of divergence in practice.

BC4 The question is relevant, for example, when the terms of the embedded derivative do not change but market conditions change and the market was the principal factor in determining whether the host contract and embedded derivative are closely related. Instances when this might arise are given in paragraph AG33(d) of IAS 39. Paragraph AG33(d) states that an embedded foreign currency derivative is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

(a) the functional currency of any substantial party to that contract;

(b) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or

(c) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).

BC5 Any of the currencies specified in (a)-(c) above may change. Assume that when an entity first became a party to a contract, it assessed the contract as containing an embedded derivative that was closely related (because it was in one of the three categories in paragraph BC4) and hence not accounted for separately. Assume that subsequently market conditions change and that if the entity were to reassess the contract under the changed circumstances it would conclude that the embedded derivative is not closely related and therefore requires separate accounting. (The converse could also arise.) The issue is whether the entity should make such a reassessment.

BC5A In 2009 the International Accounting Standards Board observed that the changes to the definition of a business combination in the revisions to IFRS 3 *Business Combinations* (as revised in 2008) caused the accounting for the formation of a joint venture by the venturer* to be within the scope of IFRIC 9. Similarly, the Board noted that common control transactions might raise the same issue depending on which level of the group reporting entity is assessing the combination.

BC5B The Board observed that during the development of the revised IFRS 3, it did not discuss whether it intended IFRIC 9 to apply to those types of transactions. The Board did not intend to change existing practice by including such transactions within the scope of IFRIC 9. Accordingly, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 5 of IFRIC 9 to clarify that IFRIC 9 does not apply to embedded derivatives in contracts acquired in a combination between entities or businesses under common control or the formation of a joint venture.

BC5C Some respondents to the exposure draft *Post-implementation Revisions to IFRIC Interpretations* published in January 2009 expressed the view that investments in associates should also be excluded from the scope of IFRIC 9. Respondents noted that paragraphs 20–23 of IAS 28 *Investments in Associates* state that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate.

BC5D In its redeliberations, the Board confirmed its previous decision that no scope exemption in IFRIC 9 was needed for investments in associates. However, in response to the comments received, the Board noted that reassessment of embedded derivatives in contracts held by an associate is not required by IFRIC 9 in any event. The investment in the associate is the asset the investor controls and recognises, not the underlying assets and liabilities of the associate.

Reassessment of embedded derivatives

BC6 The IFRIC noted that the rationale for the requirement in IAS 39 to separate embedded derivatives is that an entity should not be able to circumvent the recognition and measurement requirements for derivatives merely by embedding a derivative in a non-derivative financial instrument or other contract (for example, by embedding a commodity forward in a debt instrument). Changes in external circumstances (such as those set out in paragraph BC5) are not ways to circumvent the Standard. The IFRIC therefore concluded that reassessment was not appropriate for such changes.

BC7 The IFRIC noted that as a practical expedient IAS 39 does not require the separation of embedded derivatives that are closely related. Many financial instruments contain embedded derivatives. Separating all of these embedded derivatives would be burdensome for entities. The IFRIC noted that requiring entities to reassess embedded derivatives in all hybrid instruments could be onerous because frequent monitoring would be required. Market conditions and other factors affecting embedded derivatives would have to be monitored continuously to ensure timely identification of a change in circumstances and amendment of the accounting treatment accordingly. For example, if the functional currency of the counterparty changes during the reporting period so that the contract is no longer denominated in a currency of one of the parties to the contract, then a reassessment of the hybrid instrument would be required at the date of change to ensure the correct accounting treatment in future.

* IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31. IFRS 11 uses the term 'joint ventures' to designate parties that have joint control of a joint venture.

BC8 The IFRIC also recognised that although IAS 39 is silent on the issue of reassessment it gives relevant guidance when it states that for the types of contracts covered by paragraph AG33(b) the assessment of whether an embedded derivative is closely related is required only at inception. Paragraph AG33(b) states:

> An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest *when the contract is issued*, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (eg a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money *at inception* and are not leveraged. [Emphasis added]

BC9 The IFRIC also considered the implications of requiring subsequent reassessment. For example, assume that an entity, when it first becomes a party to a contract, separately recognises a host asset and an embedded derivative liability. If the entity were required to reassess whether the embedded derivative was to be accounted for separately and if the entity concluded some time after becoming a party to the contract that the derivative was no longer required to be separated, then questions of recognition and measurement would arise. In the above circumstances, the IFRIC identified the following possibilities:

(a) the entity could remove the derivative from its balance sheet and recognise in profit or loss a corresponding gain or loss. This would lead to recognition of a gain or loss even though there had been no transaction and no change in the value of the total contract or its components.

(b) the entity could leave the derivative as a separate item in the balance sheet. The issue would then arise as to when the item was to be removed from the balance sheet. Should it be amortised (and, if so, how would the amortisation affect the effective interest rate of the asset), or should it be derecognised only when the asset is derecognised?

(c) the entity could combine the derivative (which is recognised at fair value) with the asset (which is recognised at amortised cost). This would alter both the carrying amount of the asset and its effective interest rate even though there had been no change in the economics of the whole contract. In some cases, it could also result in a negative effective interest rate.

The IFRIC noted that, under its view that subsequent reassessment is appropriate only when there has been a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required by the contract, the above issues do not arise.

BC10 The IFRIC noted that IAS 39 requires an entity to assess whether an embedded derivative needs to be separated from the host contract and accounted for as a derivative when it first becomes a party to a contract. Consequently, if an entity purchases a contract that contains an embedded derivative it assesses whether the embedded derivative needs to be separated and accounted for as a derivative on the basis of conditions at that date.

BC11 The IFRIC considered an alternative approach of making reassessment optional. It decided against this approach because it would reduce comparability of financial information. Also, the IFRIC noted that this approach would be inconsistent with the embedded derivative requirements in IAS 39 that either require or prohibit separation but do not give an option. Accordingly, the IFRIC concluded that reassessment should not be optional.

BC11A Following the issue of *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7) in October 2008 constituents told the International Accounting Standards Board that there was uncertainty about the interaction between those amendments and IFRIC 9 regarding the assessment of embedded derivatives. Some of those taking part in the public round-table meetings held by the Board and the US Financial Accounting Standards Board in November and December 2008 in response to the global financial crisis also raised that issue. They asked the Board to consider further amendments to IFRSs to prevent any practice developing whereby, following reclassification of a financial asset, embedded derivatives that should be separately accounted for are not.

BC11B In accordance with paragraph 7 of IFRIC 9, assessment of the separation of an embedded derivative after an entity first became a party to the contract is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. Constituents told the Board that some might interpret IFRIC 9 as prohibiting the separation of an embedded derivative on the reclassification of a hybrid (combined) financial asset out of the fair value through profit or loss category unless there is a concurrent change in its contractual terms.

BC11C The Board noted that when IFRIC 9 was issued, reclassifications out of the fair value through profit or loss category were prohibited and hence IFRIC 9 did not consider the possibility of such reclassifications.

BC11D The Board was clear that it did not intend the requirements to separate particular embedded derivatives from hybrid (combined) financial instruments to be circumvented as a result of the amendments to IAS 39 issued in October 2008. Therefore, the Board decided to clarify IFRIC 9 by amending paragraph 7.

BC11E The Board believes that unless assessment and separation of embedded derivatives is done when reclassifying hybrid (combined) financial assets out of the fair value through profit or loss category, structuring opportunities are created that the embedded derivative accounting requirements in IAS 39 were intended to prevent. This is because, by initially classifying a hybrid (combined) financial instrument as at fair value through profit or loss and later reclassifying it into another category, an entity can circumvent requirements for separation of an embedded derivative. The Board also noted that the only appropriate accounting for derivative instruments is to be included in the fair value through profit or loss category.

BC11F The Board decided also to clarify that an assessment on reclassification should be made on the basis of the circumstances that existed when the entity first became a party to the contract, or, if later, the date of a change in the terms of the contract that significantly modified the cash flows that otherwise would be required under the contract. This date is consistent with one of the stated purposes of embedded derivative accounting (ie preventing circumvention of the recognition and measurement requirements for derivatives) and provides some degree of comparability. Furthermore, because the terms of the embedded features in the hybrid (combined) financial instrument have not changed, the Board did not see a reason for arriving at an answer on separation different from what would have been the case at initial recognition of the hybrid (combined) contract (or a later date of a change in the terms of the contract). In addition, the Board clarified that paragraph 11(c) of IAS 39 should not be applied in assessing whether an embedded derivative requires separation. The Board noted that before reclassification the hybrid (combined) financial instrument is necessarily classified at fair value through profit or loss so that for the purpose of the assessment on reclassification this criterion is not relevant but would, if applied for assessments made in accordance with paragraph 7A of the Interpretation, always result in no embedded derivative being separated.

First-time adopters of IFRSs

BC12 In the Implementation Guidance with IFRS 1 *First-time Adoption of International Financial Reporting Standards*, paragraph IG55 states:

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

BC13 This guidance reflects the principle in IFRS 1 that a first-time adopter should apply IFRSs as if they had been in place from initial recognition. This is consistent with the general principle used in IFRSs of full retrospective application of Standards. The IFRIC noted that the date of initial recognition referred to in paragraph IG55 is the date when the entity first became a party to the contract and not the date of first-time adoption of IFRSs. Accordingly, the IFRIC concluded that IFRS 1 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of conditions at the date when the entity first became a party to the contract and not those at the date of first-time adoption.

HK(IFRIC)-Int 12
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Effective for annual periods
beginning on or after 1 January 2008

HK(IFRIC) Interpretation 12

Service Concession Arrangements

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

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Hong Kong (IFRIC) Interpretation 12 *Service Concession Arrangements* (HK(IFRIC)-Int 12) is set out in paragraphs 1-30 and Appendices A, B and C. HK(IFRIC)-Int 12 is accompanied by information notes, 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 12
Service Concession Arrangements

References

- *Framework for the Preparation and Presentation of Financial Statements*[1]
- HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*
- HKFRS 7 *Financial Instruments: Disclosures*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 11 *Construction Contracts*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 17 *Leases*
- HKAS 18 *Revenue*
- HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- HKAS 23 *Borrowing Costs*
- HKAS 32 *Financial Instruments: Presentation*
- HKAS 36 *Impairment of Assets*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- HKAS 38 *Intangible Assets*
- HKAS 39 *Financial Instruments: Recognition and Measurement*
- HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*
- HK(SIC)-Int 29 *Service Concession Arrangements: Disclosures*[2]

Background

1 In many countries, infrastructure for public services–such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks–has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

2 In some countries, governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of such infrastructure. The infrastructure may already exist, or may be constructed during the period of the service arrangement. An arrangement within the scope of this Interpretation typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

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[1] *Framework for the Preparation and Presentation of Financial Statements* was replaced by the *Conceptual Framework for Financial Reporting* in October 2010.

[2] The title of HK(SIC)-Int 29, formerly *Disclosure – Service Concession Arrangements*, was amended by HK(IFRIC)-Int 12.

Example 2: The grantor gives the operator an intangible asset (a licence to charge users)

Arrangement terms

IE11 The terms of a service arrangement require an operator to construct a road–completing construction within two years–and maintain and operate the road to a specified standard for eight years (ie years 3-10). The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8. At the end of year 10, the service arrangement will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Table 2.1 ***Contract costs***

	Year	CU*
Construction services	1	500
	2	500
Operation services (per year)	3-10	10
Road resurfacing	8	100

* in this example, monetary amounts are denominated in 'currency units (CU) '.

IE12 The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of 200 currency units (CU200) in each of years 3-10.

IE13 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Intangible asset

IE14 The operator provides construction services to the grantor in exchange for an intangible asset, ie a right to collect tolls from road users in years 3-10. In accordance with IAS 38 *Intangible Assets*, the operator recognises the intangible asset at cost, ie the fair value of consideration transferred to acquire the asset, which is the fair value of the consideration received or receivable for the construction services delivered.

IE15 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as an intangible asset (licence to charge users of the infrastructure). The operator ~~estimates~~ measures the fair value of its consideration received ~~to be~~ as equal to the forecast construction costs plus 5 per cent margin, which the operator concludes is consistent with the rate that a market participant would require as compensation for providing the construction services and for assuming the risk associated with the construction costs. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase of the arrangement:

Table 2.2 ***Initial measurement of intangible asset***

	CU
Construction services in year 1 (CU500 x (1 + 5%))	525
Capitalisation of borrowing costs (table 2.4)	34
Construction services in year 2 (CU500 x (1 + 5%))	525
Intangible asset at end of year 2	1,084

Table 3.2 ***Dividing the operator's consideration***

Year	Total	Financial asset	Intangible asset
Construction services in year 1 (CU500 × (1 + 5%))	525	350	175
Construction services in year 2 (CU500 × (1 + 5%))	525	350	175
Total construction services	1,050	700	350
	100%	*67%**	*33%*
Finance income, at specified rate of 6.18% on receivable (see table 3.3)	22	22	-
Borrowing costs capitalised (interest paid in year<u>s</u> 1 and 2 x 33%)(see table 3.7)	11	-	11
Total fair value of the operator’s consideration	1,083	722	361

* Amount guaranteed by the grantor as a proportion of the construction services

Financial asset

IE28 The amount due from or at the direction of the grantor in exchange for the construction services meets the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*. The receivable is measured initially at fair value. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

IE29 On this basis the receivable recognised at the end of years 2 and 3 will be:

Table 3.3 ***Measurement of receivable***

	CU
Construction services in year 1 allocated to the financial asset	350
Receivable at end of year 1	350
Construction services in year 2 allocated to the financial asset	350
Interest in year 2 on receivable at end of year 1 (6.18% x CU350)	22
Receivable at end of year 2	722
Interest in year 3 on receivable at end of year 2 (6.18% x CU722)	45
Cash receipts in year 3 (see table 3.5)	(117)
Receivable at end of year 3	650

Intangible asset

IE30 In accordance with IAS 38 *Intangible Assets*, the operator recognises the intangible asset at cost, ie the fair value of the consideration received or receivable.

IE31 During the construction phase of the arrangement the operator’s asset (representing its accumulating right to be paid for providing construction services) is classified as a right to receive a licence to charge users of the infrastructure. The operator ~~estimates~~ <u>measures </u>the fair value of its consideration received or receivable as equal to the forecast construction costs plus 5 per cent<u>, which the operator concludes is consistent with the rate that a market participant would require as compensation for providing the construction services and for assuming the risk associated with the construction costs.</u> It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase:

Grantor accounting

BC15 The Interpretation does not specify the accounting by grantors, because the IFRIC's objective and priority were to establish guidance for operators. Some commentators asked the IFRIC to establish guidance for the accounting by grantors. The IFRIC discussed these comments but reaffirmed its view. It noted that in many cases the grantor is a government body, and that IFRSs are not designed to apply to not-for-profit activities in the private sector, public sector or government, though entities with such activities may find them appropriate (see *Preface to IFRSs* paragraph 9).

Existing assets of the operator

BC16 The Interpretation does not specify the treatment of existing assets of the operator because the IFRIC decided that it was unnecessary to address the derecognition requirements of existing standards.

BC17 Some respondents asked the IFRIC to provide guidance on the accounting for existing assets of the operator, stating that the scope exclusion would create uncertainty about the treatment of these assets.

BC18 In its redeliberations the IFRIC noted that one objective of the Interpretation is to address whether the operator should recognise as its property, plant and equipment the infrastructure it constructs or to which it is given access. The accounting issue to be addressed for existing assets of the operator is one of derecognition, which is already addressed in IFRSs (IAS 16 *Property, Plant and Equipment*). In the light of the comments received from respondents, the IFRIC decided to clarify that certain public-to-private service arrangements may convey to the grantor a right to use existing assets of the operator, in which case the operator would apply the derecognition requirements of IFRSs to determine whether it should derecognise its existing assets.

The significant residual interest criterion

BC19 Paragraph 5(b) of D12 proposed that for a service arrangement to be within its scope the residual interest in the infrastructure handed over to the grantor at the end of the arrangement must be significant. Respondents argued, and the IFRIC agreed, that the significant residual interest criterion would limit the usefulness of the guidance because a service arrangement for the entire physical life of the infrastructure would be excluded from the scope of the guidance. That result was not the IFRIC's intention. In its redeliberation of the proposals, the IFRIC decided that it would not retain the proposal that the residual interest in the infrastructure handed over to the grantor at the end of the arrangement must be significant. As a consequence, 'whole of life' infrastructure (ie where the infrastructure is used in a public-to-private service arrangement for the entirety of its useful life) is within the scope of the Interpretation.

Treatment of the operator's rights over the infrastructure (paragraph 11)

BC20 The IFRIC considered the nature of the rights conveyed to the operator in a service concession arrangement. It first examined whether the infrastructure used to provide public services could be classified as property, plant and equipment of the operator under IAS 16. It started from the principle that infrastructure used to provide public services should be recognised as property, plant and equipment of the party that controls its use. This principle determines which party should recognise the property, plant and equipment as its own. The reference to control stems from the *Framework*[1]:

(a) an asset is defined by the *Framework* as 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'

(b) the *Framework* notes that many assets are associated with legal rights, including the right of ownership. It goes on to clarify that the right of ownership is not essential.

[1] 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*.

BC66 The IFRIC considered when the operator should first recognise the intangible asset. The IFRIC concluded that the intangible asset (the licence) received in exchange for construction services should be recognised in accordance with general principles applicable to contracts for the exchange of assets or services.

BC67 The IFRIC noted that it is current practice not to recognise executory contracts to the extent that they are unperformed by both parties (unless the contract is onerous). IAS 37 describes executory contracts as 'contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent'. Paragraph 91 of the *Framework*[*] states:

> In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements.

BC68 Therefore, the IFRIC concluded that contracts within the scope of the Interpretation should not be recognised to the extent that they are executory. The IFRIC noted that service concession arrangements within the scope of the Interpretation are generally executory when the contracts are signed. The IFRIC also concluded that during the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) should be classified as an intangible asset to the extent that it represents a right to receive a right (licence) to charge users of the public service (an intangible asset).

Items provided to the operator by the grantor (paragraph 27)

BC69 For service arrangements within the scope of the Interpretation, pre-existing infrastructure items made available to the operator by the grantor for the purpose of the service arrangement are not recognised as property, plant and equipment of the operator.

BC70 However, different considerations apply to other assets provided to the operator by the grantor if the operator can keep or deal with the assets as it wishes. Such assets become assets of the operator and so should be accounted for in accordance with general recognition and measurement principles, as should the obligations undertaken in exchange for them.

BC71 The IFRIC considered whether such assets would represent government grants, as defined in paragraph 3 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*:

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

The IFRIC concluded that if such assets were part of the overall consideration payable by the grantor on an arms' length basis for the operator's services, they would not constitute 'assistance'. Therefore, they would not meet the definition of government grants in IAS 20 and that standard would not apply.

Transition (paragraphs 29 and 30)

BC72 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that an entity shall account for a change in accounting policy resulting from initial application of an Interpretation in accordance with any specific transitional provisions in that Interpretation. In the absence of any specific transitional provisions, the general requirements of IAS 8 apply. The general requirement in IAS 8 is that the changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable.

[*] now paragraph 4.46 of the *Conceptual Framework*

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HK (IFRIC) Interpretation 13

Customer Loyalty Programmes

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from paragraph

Hong Kong (IFRIC) Interpretation 13
CUSTOMER LOYALTY PROGRAMMES

Hong Kong (IFRIC) Interpretation 13 *Customer Loyalty Programmes* (HK(IFRIC)-Int 13) is set out in paragraphs 1 -11 and the Appendix. HK(IFRIC)-Int 13 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 13
Customer Loyalty Programmes

References

- HKFRS 13 *Fair Value Measurement*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 18 *Revenue*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Background

1 Customer loyalty programmes are used by entities to provide customers with incentives to buy their goods or services. If a customer buys goods or services, the entity grants the customer award credits (often described as "points"). The customer can redeem the award credits for awards such as free or discounted goods or services.

2 The programmes operate in a variety of ways. Customers may be required to accumulate a specified minimum number or value of award credits before they are able to redeem them. Award credits may be linked to individual purchases or groups of purchases, or to continued custom over a specified period. The entity may operate the customer loyalty programme itself or participate in a programme operated by a third party. The awards offered may include goods or services supplied by the entity itself and/or rights to claim goods or services from a third party.

Scope

3 This Interpretation applies to customer loyalty award credits that:

(a) an entity grants to its customers as part of a sales transaction, ie a sale of goods, rendering of services or use by a customer of entity assets; and

(b) subject to meeting any further qualifying conditions, the customers can redeem in the future for free or discounted goods or services.

The Interpretation addresses accounting by the entity that grants award credits to its customers.

Issues

4 The issues addressed in this Interpretation are:

(a) whether the entity's obligation to provide free or discounted goods or services ("awards") in the future should be recognised and measured by:

(i) allocating some of the consideration received or receivable from the sales transaction to the award credits and deferring the recognition of revenue (applying paragraph 13 of HKAS 18); or

(ii) providing for the estimated future costs of supplying the awards (applying paragraph 19 of HKAS 18); and

(b) If consideration is allocated to the award credits:

(i) how much should be allocated to them;

(ii) when revenue should be recognised; and

(iii) if a third party supplies the awards, how revenue should be measured.

Conclusions

5 An entity shall apply paragraph 13 of HKAS 18 and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the "initial sale"). The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

6 The consideration allocated to the award credits shall be measured by reference to their fair value~~, ie the amount for which the award credits could be sold separately~~.

7 If the entity supplies the awards itself, it shall recognise the consideration allocated to award credits as revenue when award credits are redeemed and it fulfils its obligations to supply awards. The amount of revenue recognised shall be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

8 If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (ie as the principal in the transaction) or on behalf of the third party (ie as an agent for the third party).

(a) If the entity is collecting the consideration on behalf of the third party, it shall:

(i) measure its revenue as the net amount retained on its own account, ie the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and

(ii) recognise this net amount as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.

(b) If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfils its obligations in respect of the awards.

9 If at any time the unavoidable costs of meeting the obligations to supply the awards are expected to exceed the consideration received and receivable for them (ie the consideration allocated to the award credits at the time of the initial sale that has not yet been recognised as revenue plus any further consideration receivable when the customer redeems the award credits), the entity has onerous contracts. A liability shall be recognised for the excess in accordance with HKAS 37. The need to recognise such a liability could arise if the expected costs of supplying awards increase, for example if the entity revises its expectations about the number of award credits that will be redeemed.

Effective date and transition

10 An entity shall apply this Interpretation for annual periods beginning on or after 1 July 2008. Earlier application is permitted. If an entity applies the Interpretation for a period beginning before 1 July 2008, it shall disclose that fact.

10A Paragraph AG2 was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

10B HKFRS 13, issued in June 2011, amended paragraphs 6 and AG1 – AG3. An entity shall apply those amendments when it applies HKFRS 13.

11 Changes in accounting policy shall be accounted for in accordance with HKAS 8.

Appendix—Application guidance

This appendix is an integral part of the Interpretation.

Measuring the fair value of award credits

AG1 Paragraph 6 of the consensus requires the consideration allocated to award credits to be measured by reference to their fair value~~, ie the amount for which the award credits could be sold separately~~. If ~~the fair value~~ there is not ~~directly observable~~ a quoted market price for an identical award credit, ~~it~~ fair value must be ~~estimated~~ measured using another valuation technique.

AG2 An entity may ~~estimate~~ measure the fair value of award credits by reference to the fair value of the awards for which they could be redeemed. The fair value of the award credits takes into account, as appropriate:

(a) the amount of the discounts or incentives that would otherwise be offered to customers who have not earned award credits from an initial sale; ~~and~~

(b) the proportion of award credits that are not expected to be redeemed by customers~~.~~; and

(c) non-performance risk.

If customers can choose from a range of different awards, the fair value of the award credits ~~will~~ reflects the fair values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

AG3 In some circumstances, other ~~estimation~~valuation techniques may be ~~available~~used. For example, if a third party will supply the awards and the entity pays the third party for each award credit it grants, it could ~~estimate~~measure the fair value of the award credits by reference to the amount it pays the third party, adding a reasonable profit margin. Judgement is required to select and apply the ~~estimation~~valuation technique that satisfies the requirements of paragraph 6 of the conclusions and is most appropriate in the circumstances.

Illustrative examples

These examples accompany, but are not part of, HK(IFRIC)-Int 13.

Example 1—Awards supplied by the entity

IE1 A grocery retailer operates a customer loyalty programme. It grants programme members loyalty points when they spend a specified amount on groceries. Programme members can redeem the points for further groceries. The points have no expiry date. In one period, the entity grants 100 points. Management ~~estimates~~ measures the fair value of groceries for which each loyalty point can be redeemed as 1.25 currency units (CU1.25). This amount takes into account ~~an~~ management's estimate of the discount that ~~management~~ market participants would assume when pricing the award credits. That discount takes into account market participants' expectations of the discount that ~~expects~~ would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management estimates the market participants would expect~~s~~ only 80 of these points to be redeemed. Therefore, the fair value of each point is CU1, being the fair value of the award for each loyalty point granted of CU1.25 reduced to take into account points not expected to be redeemed ((80 points/100 points) × CU1.25 = CU1). Accordingly, management defers recognition of revenue of CU100. Throughout the example, management determines that non-performance risk has an immaterial effect on the measurement of its obligation under the programme.

Year 1

IE2 At the end of the first year, 40 of the points have been redeemed in exchange for groceries, ie half of those expected to be redeemed. The entity recognises revenue of (40 points / 80[*] points) × CU100 = CU50.

Year 2

IE3 In the second year, management revises its estimate of market participants' expectations. It now expects 90 points to be redeemed altogether.

IE4 During the second year, 41 points are redeemed, bringing the total number redeemed to 40[†] + 41 = 81 points. The cumulative revenue that the entity recognises is (81 points / 90[&] points) × CU100 = CU90. The entity has recognised revenue of CU50 in the first year, so it recognises CU40 in the second year.

Year 3

IE5 In the third year, a further nine points are redeemed, taking the total number of points redeemed to 81 + 9 = 90. Management continues to expect that only 90 points will ever be redeemed, ie that no more points will be redeemed after the third year. So the cumulative revenue to date is (90 points / 90[φ] points) × CU100 = CU100. The entity has already recognised CU90 of revenue (CU50 in the first year and CU40 in the second year). So it recognises the remaining CU10 in the third year. All of the revenue initially deferred has now been recognised.

Example 2—Awards supplied by a third party

IE6 A retailer of electrical goods participates in a customer loyalty programme operated by an airline. It grants programme members one air travel point with each CU1 they spend on electrical goods. Programme members can redeem the points for air travel with the airline, subject to availability. The retailer pays the airline CU0.009 for each point.

IE7 In one period, the retailer sells electrical goods for consideration totaling CU1 million. It grants 1 million points.

[*] total number of points expected to be redeemed
[†] number of points redeemed in year 1
[&] revised estimate of total number of points expected to be redeemed
[φ] total number of points still expected to be redeemed.