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

# MEMBERS' HANDBOOK

## Update No. 191

*(Issued 24 November 2016)*

Amendments to the following Standards, Basis for Conclusions and Implementation Guidance relate mainly to the IASB's annual improvements project. Amendments are made through the annual improvements process when the amendment is considered non-urgent but necessary to clarify guidance and wording, or to correct relatively minor unintended consequences, conflicts or oversights.

These amendments were previously set out in the Appendix to the Standards but are now incorporated into the relevant Standards, Basis for Conclusions and Implementation Guidance.

Other narrow-scope amendments that were also previously set out in the Appendix to the Standards are now incorporated into the relevant Standards, Basis for Conclusions and Implementation Guidance. These narrow-scope amendments relate to clarification of the Standard.

| ***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 |
| **HONG KONG ACCOUNTING STANDARDS (HKAS)** | | |
| HKAS 16 *Property, Plant and Equipment* | Replace the cover page and pages 2, 12, 18- 20, 22, 26, 28 and 29 with the revised cover page and revised pages 2, 12, 18- 20, 22, 26, 28 and 29. Insert pages 12A after page 12, page 18A after page 18, and pages 26A-26B after page 26. | Amendments due to *Annual Improvements to HKFRSs 2010-2012 Cycle* |

| | | |
|---|---|---|
| HKAS 19 (2011)<br>*Employee Benefits* | Replace the cover page and pages 2, 4, 5, 11, 31, 34, 47-52, 54-55, 117, 121-129 with the revised cover page and revised pages 2, 4, 5, 11, 31, 34, 47-52, 54-55, 117, 121-129. Insert pages 31A after page 31, pages 91A-91B after page 91, and page 117A after page 117. Discard Pages 123A-123C and 130-134. | Amendments due to Amendments to HKAS 19 – *Defined Benefit Plans: Employee Contributions* |
| HKAS 24 (Revised)<br>*Related Party Disclosures* | Replace the cover page and pages 2, 6, 8, 9, 11 and 22 with the revised cover page and revised pages 2, 6, 8, 9, 11 and 22. Insert page 22A after page 22. | Amendments due to *Annual Improvements to HKFRSs 2010-2012 Cycle* |
| HKAS 37<br>*Provisions, Contingent Liabilities and Contingent Assets* | Replace the cover page and pages 2 and 8 with the revised cover page and revised pages 2 and 8. Insert page 19A after page 19. | Amendments due to *Annual Improvements to HKFRSs 2010-2012 Cycle* |
| HKAS 38<br>*Intangible Assets*<br>(Standard) | Replace the cover page and pages 2, 25 and 35 with the revised cover page and revised pages 2, 25 and 35. Insert page 25A after page 25 and page 35A after page 35. | Amendments due to *Annual Improvements to HKFRSs 2010-2012 Cycle* |
| HKAS 38<br>*Intangible Assets*<br>(Basis for Conclusions) | Replace the cover page and pages 3 and 26 with the revised cover page and revised pages 3 and 26. Insert page 26A after page 26 and page 31A after 31. | |
| HKAS 39<br>*Financial Instruments: Recognition and Measurement*<br>(Standard) | Replace the cover page and pages 2, 14 and 47 with the revised cover page and revised pages 2, 14 and 47. | Amendments due to *Annual Improvements to HKFRSs 2010-2012 Cycle* |
| HKAS 39<br>*Financial Instruments: Recognition and Measurement*<br>(Basis for Conclusions) | Replace the cover page and page 32 with the revised cover page and revised page 32. | |
| HKAS 40<br>*Investment Property* | Replace the cover page and pages 2, 3, 7, 8, 20 and 24 with the revised cover page and revised pages 2, 3, 7, 8, 20 and 24. Insert page 8A after page 8 and page 24A after page 24. | Amendments due to *Annual Improvements to HKFRSs 2011-2013 Cycle* |

**HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)**

| | | |
|---|---|---|
| HKFRS 1 (Revised)<br>*First-time Adoption of Hong Kong Financial Reporting Standards*<br>(Standard) | Replace the cover page and pages 2 and 23 with the revised cover page and revised pages 2 and 23. | Amendments due to<br>- *Annual Improvements to HKFRSs 2011-2013 Cycle* |
| HKFRS 1 (Revised)<br>*First-time Adoption of Hong Kong Financial Reporting Standards*<br>(Basis for Conclusions) | Replace the cover page and page 8 with the revised cover page and revised page 8. Insert page 8A after page 8. | - Editorial amendments |
| HKFRS 2<br>*Share-based Payment*<br>(Standard) | Replace the cover page and pages 11, 12, 23, 25-27 and 44 with the revised cover page and revised pages 11, 12, 23, 25-27 and 44. | Amendments due to<br>- *Annual Improvements to HKFRSs 2010-2012 Cycle*<br>- Editorial amendments |
| HKFRS 2<br>*Share-based Payment*<br>(Basis for Conclusions) | Replace the cover page and pages 4 and 74 with the revised cover page and revised pages 4 and 74. Insert page 4A after page 4 and pages 74A-74F after page 74. | |
| HKFRS 2<br>*Share-based Payment*<br>(Guidance on Implementing) | Replace the cover page and pages 33-36 and 38 with the revised cover page and revised pages 33-36 and 38. | |
| HKFRS 3 (Revised)<br>*Business Combinations*<br>(Standard) | Replace the cover page and pages 1A, 3, 8, 14, 18 and 19 with the revised cover page and revised pages 1A, 3, 8, 14, 18 and 19. Insert pages 19A-19B after page 19. | Amendments due to<br>- *Annual Improvements to HKFRSs 2010-2012 Cycle*<br>- *Annual Improvements to HKFRSs 2011-2013 Cycle* |
| HKFRS 3 (Revised)<br>*Business Combinations*<br>(Basis for Conclusions) | Replace the cover page and pages 5, 17, 75 and 92-94 with the revised cover page and revised pages 5, 17, 75 and 92-94. Insert page 17A after page 17, pages 75A-75B after 75 and page 92A after 92. | |
| HKFRS 3 (Revised)<br>*Business Combinations*<br>(Illustrative Examples and Comparison with SFAS 141(R)) | Replace the cover page and pages 28 and 36 with the revised cover page and revised pages 28 and 36. Insert page 28A after page 28. | |

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|---|---|---|
| HKFRS 8<br>*Operating Segments*<br>(Standard) | Replace the cover page and pages 2, 11, 14 and 16 with the revised cover page and revised pages 2, 11, 14 and 16. | Amendments due to *Annual Improvements to HKFRSs 2010-2012 Cycle* |
| HKFRS 8<br>*Operating Segments*<br>(Basis for Conclusions) | Replace the cover page and pages 2-3 and 8-9 with the revised cover page and revised pages 2-3 and 8-9. Insert page 8A after page 8. | |
| HKFRS 13<br>*Fair Value Measurement*<br>(Standard) | Replace the cover page and pages 2, 16 and 44 with the revised cover page and revised pages 2, 16 and 44. | Amendments due to<br>- *Annual Improvements to HKFRSs 2010-2012 Cycle*<br>- *Annual Improvements to HKFRSs 2011-2013 Cycle* |
| HKFRS 13<br>*Fair Value Measurement*<br>(Basis for Conclusions) | Replace the cover page and pages 2-3, 28-29, 31-32 and 49 with the revised cover page and revised pages 2-3, 28-29, 31-32 and 49. Insert page 29A after page 29, page 32A after 32 and page 49A after 49. | |
| *Annual Improvements to HKFRSs 2010-2012 Cycle* | Discard the document. | Amendments have been incorporated into relevant HKFRSs |
| *Annual Improvements to HKFRSs 2011-2013 Cycle* | Discard the document. | Amendments have been incorporated into relevant HKFRSs |

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

| | | |
|---|---|---|
| HK(IFRIC) - Int 14<br>*HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* | Replace the cover page and pages 2 and 12 with the revised cover page and revised pages 2 and 12 | Amendments due to HKAS 19 (2011) *Employee Benefits* |

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(Updated to November 2016)

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


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HKAS 16
Revised ~~August 2014~~November 2016

*Hong Kong Accounting Standard 16*

# Property, Plant and Equipment

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## 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]

33 [Deleted]

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~~ the carrying amount of that asset is adjusted to the revalued amount. A~~a~~t the date of the revaluation, the asset is treated in one of the following ways:

(a) ~~restated proportionately~~ the gross carrying amount is adjusted in a manner that is consistent with the ~~change in the gross carrying amount of the asset so that~~ revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or ~~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 replacement cost (see HKFRS 13).~~

(b) the accumulated depreciation is 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.**

**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]**

**(d) [deleted]**

**(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 Paragraph 35 was amended by *Annual Improvements to HKFRSs 2010–2012 Cycle*. An entity shall apply that amendment to all revaluations recognised in annual periods beginning on or after the date of initial application of that amendment and in the immediately preceding annual period. An entity may also present adjusted comparative information for any earlier periods presented, but it is not required to do so. If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been presented on a different basis and explain that basis.

**80AA 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.**

**80AB 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.

81H *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraph 35 and added paragraph 80A. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. 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 80AA**<br><br>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 80AB**<br><br>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. |

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**Amendments to Basis for Conclusions on IAS 16 and IAS 41 *Agriculture: Bearer Plants***

(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.

## Revaluation method—proportionate restatement of accumulated depreciation when an item of property, plant and equipment is revalued

BC25A The IFRS Interpretations Committee reported to the Board that practice differed in calculating the accumulated depreciation for an item of property, plant and equipment that is measured using the revaluation method in cases in which the residual value, the useful life or the depreciation method has been re-estimated before a revaluation.

BC25B Paragraph 35(a) required that, in instances in which the gross carrying amount is revalued, the revalued accumulated depreciation is restated proportionately with the change in the gross carrying amount.

BC25C The submission noted that applying the same proportionate factor to restate the accumulated depreciation as for the change in the gross carrying amount has caused problems in practice if the residual value, the useful life or the depreciation method has been re-estimated before the revaluation. The submission used an example in which both the gross carrying amount and the carrying amount were revalued.

BC25D In such cases, divergent views existed as to how to calculate the accumulated depreciation when the item of property, plant and equipment is revalued:

(a) some think that the restatement of the accumulated depreciation is not always proportionate to the change in the gross carrying amount and that paragraph 35(a) should be amended accordingly.

(b) others are of the opinion that the accumulated depreciation and the gross carrying amount should always be restated proportionately when applying paragraph 35(a). The difference between the amount required for a proportionate restatement of the depreciation and the actual restatement of the depreciation required for the gross carrying amount to result in a carrying amount equal to the revalued amount being treated as an accounting error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC25E The definition of 'carrying amount' in paragraph 6 is "the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment loss". The Board noted that, when revaluing an item of property, plant and equipment, the definition implies that the accumulated depreciation is calculated as the difference between the gross carrying amount and the carrying amount, after taking into account accumulated impairment losses.

BC25F The Board agrees with the proponents of the view presented in paragraph BC25D(a) that the restatement of the accumulated depreciation is not always proportionate to the change in the gross carrying amount. The Board noted that the accumulated depreciation would not be able to be restated proportionately to the gross carrying amount in situations in which both the gross carrying amount and the carrying amount are revalued non-proportionately to each other. It was noted that this was the case regardless of whether there had been a re-estimation of residual value, the useful life or the depreciation method in a prior period.

BC25G For example, when the revalued amounts for the gross carrying amount and the carrying amount both reflect non-proportionate observable data, it is demonstrated that accumulated depreciation cannot be proportionately restated to the gross carrying amount in order for the carrying amount to equal the gross carrying amount less any accumulated depreciation and accumulated impairment losses. In that respect, the Board thinks that the requirements in paragraph 35(a) may be perceived as being inconsistent with the definition of carrying amount.

BC25H In addition, the Board noted that the second sentence in paragraph 35(a) reinforced that inconsistency because it states that proportionate restatement is often used when an asset is revalued by means of applying an index to determine its replacement cost. It reinforced the inconsistency because the determination of the accumulated depreciation does not depend on the selection of the valuation technique used for the revaluation under the revaluation model for property, plant and equipment.

BC25I Consequently, the Board decided to:

(a) amend paragraph 35(a) to state that the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount;

(b) amend paragraph 35(a) to state that the accumulated depreciation is calculated as the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses; and

(c) delete the references to valuation methods in paragraph 35(a)–(b).

The Board also decided to amend paragraph 35(b) to be consistent with the wording used in those amendments.

BC25J The Board decided to include wording in paragraph 35(a) to require an entity to take into account accumulated impairment losses when adjusting the depreciation on revaluation. This was to ensure that when future revaluation increases occur, the correct split, in accordance with paragraph 39 of IAS 16 and paragraph 119 of IAS 36 *Impairment of Assets*, is made between profit or loss and other comprehensive income when reversing prior accumulated impairment losses.

## 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.

## 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.

BC36A *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, amended paragraph 35. The Board also decided that the amendment should be required to be applied to all revaluations occurring in annual periods beginning on or after the date of initial application of the amendments and in the immediately preceding annual period. The Board was concerned that the costs of full retrospective application might outweigh the benefits.

## 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.

HKAS 19 (2011)
Revised ~~December 2013~~November 2016

Effective for annual periods
beginning on or after 1 January 2013

*Hong Kong Accounting Standard 19 (2011)*

# Employee Benefits

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

## COPYRIGHT

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**AMENDMENTS TO GUIDANCE ON OTHER HKFRSs**

**TABLE OF CONCORDANCE**

Hong Kong Accounting Standard 19 *Employee Benefits* (HKAS 19) is set out in paragraphs 1–17~~3~~5 and the Appendix. All the paragraphs have equal authority. HKAS 19 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.

***Assets held by a long-term employee benefit fund* are assets (other than non-transferable financial instruments issued by the reporting entity) that:**

**(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and**

**(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:**

**(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or**

**(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.**

**A *qualifying insurance policy* is an insurance policy[*] issued by an insurer that is not a related party (as defined in HKAS 24 *Related Party Disclosures*) of the reporting entity, if the proceeds of the policy:**

**(a) can be used only to pay or fund employee benefits under a defined benefit plan; and**

**(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:**

**(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or**

**(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.**

***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*.)~~the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction~~.**

## Definitions relating to defined benefit cost

***Service cost* comprises:**

***(a) current service cost*, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;**

***(b) past service cost*, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and**

**(c) any gain or loss on settlement.**

[*] A qualifying insurance policy is not necessarily an insurance contract, as defined in HKFRS 4 *Insurance Contracts*.

89 Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the end of the reporting period. Such changes will result in:

(a) past service cost, to the extent that they change benefits for service before the change; and

(b) current service cost for periods after the change, to the extent that they change benefits for service after the change.

90 Estimates of future salary increases take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

91 Some defined benefit plans limit the contributions that an entity is required to pay. The ultimate cost of the benefits takes account of the effect of a limit on contributions. The effect of a limit on contributions is determined over the shorter of:

(a) the estimated life of the entity; and

(b) the estimated life of the plan.

92 Some defined benefit plans require employees or third parties to contribute to the cost of the plan. Contributions by employees reduce the cost of the benefits to the entity. An entity considers whether third-party contributions reduce the cost of the benefits to the entity, or are a reimbursement right as described in paragraph 116. Contributions by employees or third parties are either set out in the formal terms of the plan (or arise from a constructive obligation that goes beyond those terms), or are discretionary. Discretionary contributions by employees or third parties reduce service cost upon payment of these contributions to the plan.

93 Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or ~~reduce~~ affect remeasurements of the net defined benefit liability (asset) (if they are not linked to service). An example of contributions that are not linked to service is when ~~(eg if~~ the contributions are required to reduce a deficit arising from losses on plan assets or from actuarial losses~~)~~. If c~~C~~ontributions from employees or third parties are linked to ~~in respect of~~ service, those contributions reduce the service cost as follows: ~~are attributed to periods of service as a negative benefit in accordance with paragraph 70 (ie the net benefit is attributed in accordance with that paragraph).~~

(a) if the amount of the contributions is dependent on the number of years of service, an entity shall attribute the contributions to periods of service using the same attribution method required by paragraph 70 for the gross benefit (ie either using the plan's contribution formula or on a straight-line basis); or

(b) if the amount of the contributions is independent of the number of years of service, the entity is permitted to recognise such contributions as a reduction of the service cost in the period in which the related service is rendered. Examples of contributions that are independent of the number of years of service include those that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age.

Paragraph A1 provides related application guidance.

94 For contributions from employees or third parties that are attributed to periods of service in accordance with paragraph 93(a), c~~C~~hanges in ~~employee or third-party~~ the contributions ~~in respect of service~~ result in:

(a) current and past service cost (if those changes ~~in employee contributions~~ are not set out in the formal terms of a plan and do not arise from a constructive obligation); or

(b) actuarial gains and losses (if those changes ~~in employee contributions~~ are set out in the formal terms of a plan, or arise from a constructive obligation).

95 Some post-employment benefits are linked to variables such as the level of state retirement benefits or state medical care. The measurement of such benefits reflects the best estimate of such variables, based on historical data and other reliable evidence.

111 A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan (other than a payment of benefits to, or on behalf of, employees in accordance with the terms of the plan and included in the actuarial assumptions). For example, a one-off transfer of significant employer obligations under the plan to an insurance company through the purchase of an insurance policy is a settlement; a lump sum cash payment, under the terms of the plan, to plan participants in exchange for their rights to receive specified post-employment benefits is not.

112 In some cases, an entity acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the entity retains a legal or constructive obligation (see paragraph 46) to pay further amounts if the insurer does not pay the employee benefits specified in the insurance policy. Paragraphs 116–119 deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.

## Recognition and measurement: plan assets

### Fair value of plan assets

113 The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus. ~~When no market price is available, the fair value of plan assets is estimated, for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).~~

114 Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

115 Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

### Reimbursements

**116 When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall:**

**(a) recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value.**

**(b) disaggregate and recognise changes in the fair value of its right to reimbursement in the same way as for changes in the fair value of plan assets (see paragraphs 124 and 125). The components of defined benefit cost recognised in accordance with paragraph 120 may be recognised net**

## Transition and effective date

172 **An entity shall apply this Standard for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this Standard for an earlier period, it shall disclose that fact.**

173 **An entity shall apply this Standard retrospectively, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except that:**

(a) **an entity need not adjust the carrying amount of assets outside the scope of this Standard for changes in employee benefit costs that were included in the carrying amount before the date of initial application. The date of initial application is the beginning of the earliest prior period presented in the first financial statements in which the entity adopts this Standard.**

(b) **in financial statements for periods beginning before 1 January 2014, an entity need not present comparative information for the disclosures required by paragraph 145 about the sensitivity of the defined benefit obligation.**

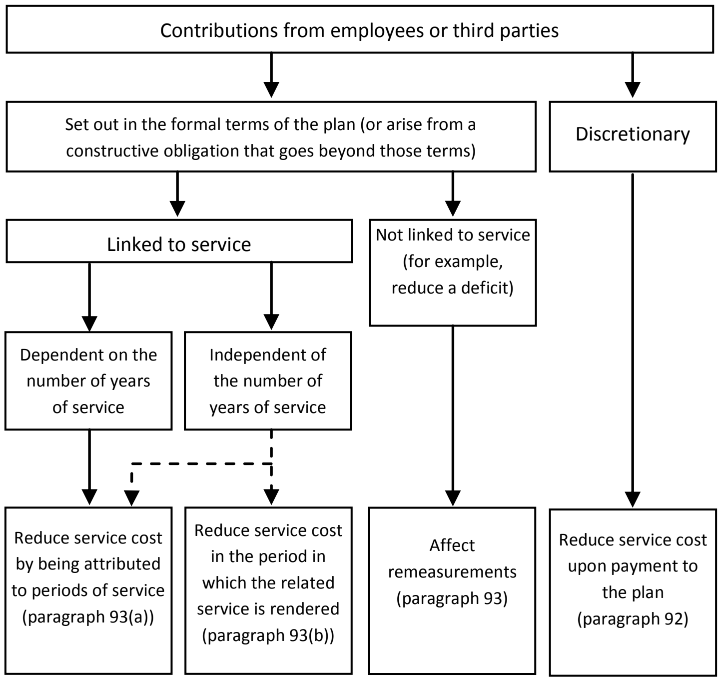
174 HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 8 and amended paragraph 113. An entity shall apply those amendments when it applies HKFRS 13.

175 *Defined Benefit Plans: Employee Contributions* (Amendments to HKAS 19), issued in December 2013, amended paragraphs 93–94. An entity shall apply those amendments for annual periods beginning on or after 1 July 2014 retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

# Appendix A
# Application Guidance

*This appendix is an integral part of the HKFRS. It describes the application of paragraphs 92–93 and has the same authority as the other parts of the HKFRS.*

A1 The accounting requirements for contributions from employees or third parties are illustrated in the diagram below.




(1) This dotted arrow means that an entity is permitted to choose either accounting.

# Appendix ~~A~~B
# Amendments to other HKFRSs

*This appendix sets out amendments to other HKFRSs that are a consequence of amending HKAS 19 in July 2011. An entity shall apply these amendments when it applies HKAS 19 as amended. Amended paragraphs are shown with new text underlined and deleted text struck through.*

*****

*The amendments contained in this appendix when this Standard was amended in 2011 have been incorporated into the relevant Standards.*

# Appendix ~~B~~C
# Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in July 2011 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 19.

The International Financial Reporting Standard comparable with HKAS 19 is IAS 19 *Employee Benefits*.

There are no major textual differences between HKAS 19 and IAS 19.

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**APPENDIX**

**Amendments to the Basis for Conclusions on other IFRSs**

~~**Amendments to the Basis for Conclusions on IAS 19**~~
~~***– Defined Benefit Plans: Employee Contributions***~~

**DISSENTING OPINIONS**

## Contributions from employees or third parties: amendments issued in 2013

BC150A In 2012, the IFRS Interpretations Committee (the 'Interpretations Committee') received two submissions that requested clarification of the accounting requirements set out in paragraph 93 of IAS 19 for contributions from employees or third parties.

BC150B The Interpretations Committee considered whether some types of contributions from employees or third parties to a defined benefit plan should reduce the cost of short-term employee benefits instead of reducing the cost of post-employment benefits. The Interpretations Committee observed that the wording in paragraph 93 of IAS 19 appeared to suggest that all employee contributions that are linked to service should be attributed to periods of service as a reduction of service cost (ie as a negative benefit). However, employee contributions that are linked solely to the employee's service rendered in the same period in which those contributions are payable (for example, contributions that are a fixed percentage of salary throughout the period of the employment) might also be considered to be a reduction of the cost of short-term employee benefits (ie a reduction in salary). Consequently, the Interpretations Committee recommended to the IASB that it should amend IAS 19 regarding the accounting for such contributions.

BC150C In the IASB's view, contributions from employees or third parties that are required by the terms of a defined benefit plan should form part of the post-employment benefit rather than the short-term employee benefit. Consequently, such contributions should be attributed to periods of service as a reduction of service cost (ie as a negative benefit). However, the IASB acknowledged the general concern about the complexity of the required calculations that could result from the requirement to attribute the net benefit to periods of service. The IASB thus concluded that the costs of applying the attribution requirements to some simple types of contributory plans outweighed the benefits and so the IASB decided to add a practical expedient to paragraph 93.

BC150D Consequently, in March 2013, the IASB published the Exposure Draft ED/2013/4 *Defined Benefit Plans: Employee Contributions* ('ED/2013/4'), which proposed amendments to paragraph 93 of IAS 19. In ED/2013/4 the IASB proposed that some contributions from employees or third parties may be excluded from being attributed to periods of service as a negative benefit. Instead, those contributions could be recognised as a reduction in the service cost in the period in which they are payable if, and only if, they are linked solely to the employee's service rendered in that period. An example of such a situation would be contributions based on an employee's salary at a fixed percentage that does not depend on the number of years of service by the employee to the employer. On the other hand, if an employee is required to contribute a higher percentage of salary in later years of service, then the contributions are not linked solely to the employee's service that is rendered in the period in which the contributions are payable.

BC150E When developing ED/2013/4, the IASB observed that paragraph 93 first states that contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with paragraph 70, and then states that the net benefit is attributed in accordance with paragraph 70. The references to both the negative benefit and net benefit might cause confusion as to whether the back-end loading test in paragraph 70 is required to be performed on the net benefit, or on the gross benefit and the negative benefit separately. The IASB observed that performing the test on the net benefit would add complexity and that the outcome of that test would differ from the outcome of performing the test on the gross benefit and the negative benefit separately. Consequently, the

IASB proposed to specify in paragraph 93 that the contributions from employees or third parties that are not solely linked to current-year service should be attributed to periods of service using the same method of attribution as the gross benefit in accordance with paragraph 70.

BC150F A total of 63 respondents commented on ED/2013/4. The majority of respondents supported the proposed amendments, but about half of them requested either further clarification of the scope of the practical expedient or the addition of application guidance or examples.

BC150G Some respondents requested clarification of whether they could apply the proposed practical expedient if the amount of the contributions depended on the employee's age instead of the number of years of service (age-based contributions). The IASB observed that examples illustrating the proposed practical expedient in ED/2013/4 implied two criteria—one is whether contributions are a fixed percentage of salary and the other is whether the contributions are independent of the number of years of service.

BC150H The IASB considered whether contributions should have to meet either or both of the criteria to qualify for the practical expedient. In some circumstances, age-based contributions could approximate contributions that depend on the number of years of service, because both of the contribution formulas depend on time. However, age-based contributions are independent of the number of years of service. For example, the terms of a plan require employee contributions of four per cent of salary for the first ten years and then six per cent thereafter. The increase to six per cent is not only related to the service in the current year, but is also related to the first ten years of service, which is a prerequisite for the change in the contribution percentage. If the terms of the plan required employee contributions of four per cent of salary if the employee was 30 years old or younger and six per cent if the employee was more than 30 years old, then an employee would be required to contribute either four per cent or six per cent regardless of the length of their service. In other words, the contributions paid for each year are not dependent on prior service.

BC150I Consequently, the IASB decided that the practical expedient should be permitted if the amount of the contributions is independent of the number of years of service. This principle would also help to clarify whether the practical expedient would apply to other types of contribution arrangements, including contributions that are a fixed amount (as opposed to a fixed percentage) regardless of the number of years of service.

BC150J One respondent to ED/2013/4 was concerned that some might interpret the requirements to attribute contributions from employees or third parties to periods of service to mean that the accumulated value of contributions should be deducted from both the defined benefit obligation and the plan assets. The IASB noted that the plan assets and the defined benefit obligation would increase by the amount of the contributions paid. This is because the contributions that are paid increase the employer's obligation to the employees even if those contributions are attributed to other periods of service to reflect the net cost to the employer.

BC150K When developing the amendments, the IASB observed that paragraph 94 sets out requirements for the accounting for changes in employee or third-party contributions. The IASB noted that the requirements in that paragraph apply to contributions that are attributed to periods of service using the same attribution method that is required by paragraph 70 for the gross benefit. Consequently, the IASB decided to amend paragraph 94 to clarify the scope of the requirements in that paragraph.

(b) In financial statements for periods beginning before 1 January 2014, an entity need not provide comparatives for the disclosures about the sensitivity of the defined benefit obligation. The Board provided this exemption to provide sufficient lead time for entities to implement the necessary systems.

## First-time adopters

BC270 For entities adopting IFRSs for the first time, the amendments made in 2011 are to be applied retrospectively as required by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The Board included a temporary exemption for entities adopting IFRSs to use paragraph 173(b) for the same reasons as given in paragraph BC269(b).

## Early application

BC271 The amendments made in 2011 will improve the accounting and, in particular, the disclosures provided by a reporting entity in relation to its participation in defined benefit plans. In addition, some of the amendments address existing problems in applying IAS 19 in practice. The Board noted that the majority of the amendments made in 2011 are permitted by the previous version of IAS 19. Consequently, the Board permitted early application of all the amendments made in 2011.

## Transition provisions for *Defined Benefit Plans: Employee Contributions*

BC271A In ED/2013/4, the IASB proposed retrospective application and to permit earlier application of the amendments. The majority of the respondents supported those proposals. Some respondents questioned whether retrospective application was practicable because some calculations might require information that is not readily available. The IASB observed that in current practice, contributions from employees or third parties are generally reduced from service cost without being attributed to periods of service. The proposed amendments are intended to provide relief so that entities can deduct contributions from service cost in the period in which the service is rendered, which was common practice prior to the 2011 amendments to IAS 19. The impact of retrospective application would therefore be minimal in those cases. Consequently, the IASB decided to retain the requirement for retrospective application.

BC271B The amendments to IAS 19 published in 2011 are effective for annual periods beginning on or after 1 January 2013. In the IASB's view, the objective of the amendments published in 2013 is to provide relief in the accounting for contributions from employees or third parties and, therefore, the effective date should be set as early as possible, while allowing jurisdictions to have sufficient time to prepare for the new requirements. Consequently, the IASB decided that the effective date of the amendments should be 1 July 2014, with earlier application permitted.

## Summary of changes from the 2010 ED and 2005 ED: amendments issued in 2011

BC272 The main changes from the 2010 ED are:

(a) The amendments do not specify where in profit or loss an entity should present the net interest component. The 2010 ED proposed that an entity should include the net interest component as part of finance cost in profit or loss.

(b) The amendments require gains and losses on settlement to be included in service cost. The 2010 ED proposed that gains and losses on settlement should be included in remeasurements.

(c) The amendments do not require the following disclosures proposed in the 2010 ED:

(i) the defined benefit obligation, excluding projected growth in salaries;

(ii) sensitivity of current service cost to changes in actuarial assumptions; and

(iii) a description of the process used to determine the demographic actuarial assumptions.

(d) The amendments align the timing of recognition for plan amendments, termination benefits and restructuring costs. The 2010 ED proposed aligning the timing of recognition for plan amendments and termination benefits only.

(e) The amendments do not:

(i) combine the post-employment and other long-term employee benefit categories, as had been proposed in the 2010 ED.

# Appendix
# Amendments to the Basis for Conclusions on other IFRSs

*This appendix contains amendments to the Basis for Conclusions (and related appendices) on other IFRSs that are necessary in order to ensure consistency with IAS 19 and the related amendments to other IFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.*

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*The amendments contained in this appendix when IAS 19, as amended in 2011, was issued have been incorporated into the Basis for Conclusions on the relevant Standards.*

# Dissenting opinions

## Dissent of James J Leisenring and Tatsumi Yamada from the issue in December 2004 of *Actuarial Gains and Losses, Group Plans and Disclosures* (Amendment to IAS 19)*

## Mr Leisenring

DO1 Mr Leisenring dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.

DO2 Mr Leisenring dissents because he disagrees with the deletion of the last sentence in paragraph 40 and the addition of paragraphs 41 and 42. He believes that group entities that give a defined benefit promise to their employees should account for that defined benefit promise in their separate or individual financial statements. He further believes that separate or individual financial statements that purport to be prepared in accordance with IFRSs should comply with the same requirements as other financial statements that are prepared in accordance with IFRSs. He therefore disagrees with the removal of the requirement for group entities to treat defined benefit plans that share risks between entities under common control as defined benefit plans and the introduction instead of the requirements of paragraph 41.

DO3 Mr Leisenring notes that group entities are required to give disclosures about the plan as a whole but does not believe that disclosures are an adequate substitute for recognition and measurement in accordance with the requirements of IAS 19.

## Mr Yamada

DO4 Mr Yamada dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.

DO5 Mr Yamada agrees that an option should be added to IAS 19 that allows entities that recognise actuarial gains and losses in full in the period in which they occur to recognise them outside profit or loss in a statement of recognised income and expense, even though under the previous IAS 19 they can be recognised in profit or loss in full in the period in which they occur. He agrees that the option provides more transparent information than the deferred recognition options commonly chosen under IAS 19. However, he also believes that all items of income and expense should be recognised in profit or loss in some period. Until they have been so recognised, they should be included in a component of equity separate from retained earnings. They should be transferred from that separate component of equity into retained earnings when they are recognised in profit or loss. Mr Yamada does not, therefore, agree with the requirements of paragraph 93D.†

* Cross-references have been updated.

† The amendments to IAS 19 made in 2011 deleted paragraph 93D.

DO6 Mr Yamada acknowledges the difficulty in finding a rational basis for recognising actuarial gains and losses in profit or loss in periods after their initial recognition in a statement of recognised income and expense when the plan is ongoing. He also acknowledges that, under IFRSs, some gains and losses are recognised directly in a separate component of equity and are not subsequently recognised in profit or loss. However, Mr Yamada does not believe that this justifies expanding this treatment to actuarial gains and losses.

DO7 The cumulative actuarial gains and losses could be recognised in profit or loss when a plan is wound up or transferred outside the entity. The cumulative amount recognised in a separate component of equity would be transferred to retained earnings at the same time. This would be consistent with the treatment of exchange gains and losses on subsidiaries that have a measurement currency different from the presentation currency of the group.

DO8 Therefore, Mr Yamada believes that the requirements of paragraph 93D mean that the option is not an improvement to financial reporting because it allows gains and losses to be excluded permanently from profit or loss and yet be recognised immediately in retained earnings.

# Dissent of Jan Engström and Tatsumi Yamada from the issue in June 2011 of IAS 19 as amended

## Mr Engström

DO1 Mr Engström voted against the amendments made to IAS 19 in 2011. The project was a limited scope project focused on bringing the full post-employment benefit onto the statement of financial position and on eliminating the corridor approach.

DO2 In Mr Engström's view, during the project it has become increasingly clear that a review of the measurement principles is much needed— something not included in the limited scope of the project. During the recent financial crisis the defined benefit obligation could be as much as 50 per cent higher in one company compared with an identical defined benefit obligation in another company operating in an adjacent country, with basically equal macroeconomic parameters, due to the imperfections in measurement requirements of IAS 19.

DO3 In Mr Engström's view, the amendments to IAS 19 made in 2011 introduce some radical changes from a principle point of view by not requiring some income and expenses truly related to a company's activities ever to be presented in profit or loss, indeed actually prohibiting such presentation. The adjustments of the defined benefit obligation, and of the plan assets, have for many companies been a very significant amount and by presenting income and expenses resulting from these adjustments only in other comprehensive income this project continues the gradual erosion of the concept of profit or loss.

DO4 Mr Engström sees no reason why the remeasurements component could not be subsequently reclassified to profit or loss on a reasonable basis consistently with the assumptions used to measure the defined benefit obligation.

DO5 Mr Engström would favour a comprehensive review of IAS 19, including a review of measurement, and he would prefer presentation to be decided only after the IASB has taken a stance on what profit or loss is, what other comprehensive income is and what should be subsequently reclassified into profit or loss.

DO6 As a consequence of these amendments made to IAS 19, and of the option introduced in IFRS 9 *Financial Instruments*, some material amounts may never be presented in profit or loss. IFRS 9 introduced an option to present some gains and losses on equity instruments not held for trading in other comprehensive income, without subsequent reclassification to profit or loss. In Mr Engström's view, these recent ad hoc decisions push financial reporting de facto towards a single income statement as some matters truly related to a company's activities are never to be presented in profit or loss.

## Mr Yamada

DO7 Mr Yamada voted against the amendments made to IAS 19 in 2011.

DO8 Mr Yamada agrees with the Board's view in paragraph BC70 that immediate recognition of all changes in the fair values of plan assets and in the defined benefit obligation in the period in which those changes occur provides information that is more relevant to users of financial statements than the information provided by deferred recognition. Mr Yamada also agrees that immediate recognition provides a more faithful representation of defined benefit plans and is easier for a user to understand.

DO9 However, Mr Yamada does not agree with:

(a) the disaggregation of defined benefit cost (see paragraph DO10);

(b) the definition of net interest and remeasurements of the net defined benefit liability (asset) (see paragraphs DO11–DO14); and

(c) the presentation of remeasurements of the net defined benefit liability (asset) in other comprehensive income (see paragraphs DO15–DO17).

## Disaggregation of defined benefit cost

DO10 In Mr Yamada's view the disaggregation of defined benefit cost into components (ie service cost, net interest and remeasurements) in profit or loss and other comprehensive income in paragraph 120 is not consistent with the presentation of plan assets and the defined benefit obligation in the statement of financial position. In his view, to be consistent with the presentation of a single net defined benefit liability (asset) in the statement of financial position, the presentation of changes in the net defined benefit liability (asset) should be a single net amount presented in profit or loss. Therefore, he does not agree with paragraph 134 not to specify how to present service cost and net interest on the net defined benefit liability (asset). He understands the usefulness of disaggregated information, but believes that an appropriate way of providing information on the components of defined benefit cost is to show them in the notes to the financial statements.

## Definition of net interest and remeasurements on the net defined benefit liability (asset)

DO11 Mr Yamada sees no principle behind the disaggregation described in paragraph 120 (ie service cost, net interest and remeasurements). In particular, in his view the approach for calculating net interest on the net defined benefit liability (asset) is not an improvement in financial reporting.

DO12 In Mr Yamada's view there is no reason for requiring the component of the return on plan assets presented in profit or loss to be determined using the rate used to discount the defined benefit obligation as is in paragraph 125. He agrees with the respondents' concerns summarised in paragraph BC82 that plan assets may be made up of many different types of investments, and that 'the return on high quality corporate bonds would be arbitrary and would not be a faithful representation of the return that investors require or expect from each type of asset.' Therefore, in his view, it does not provide more useful information to use the rate used to discount the defined benefit obligation in place of the previous requirement to use expected return on plan assets.

DO13 Mr Yamada does not agree that the Board should require 'using the same rate [for plan assets] as the rate used to discount the liability [as] a practical approach that … would not require an entity to make a subjective judgement on how to divide the return on plan assets into an interest component and a remeasurement' (paragraph BC82). He agrees that determining the 'expected return on plan assets' that is used by the previous version of IAS 19 requires judgement by management, but this does not mean that the 'expected return on plan assets' is unreliable. In his view, estimating the 'expected return on plan assets' requires the same degree of judgement as do other accounting estimates.

DO14 In Mr Yamada's view, there is no clear explanation about the nature of the remeasurements component, nor why disaggregation of this amount is appropriate. In the previous version of IAS 19, actuarial gains and losses on plan assets were defined as experience adjustments, ie the effects of differences between the previous actuarial assumptions (the expected return on assets) and what actually occurred. However, paragraph BC86 explains the nature of the remeasurements component as being a residual after determining the service cost and net interest components, and simply restates the definition of remeasurements in paragraph 7.

### Presentation of remeasurements in other comprehensive income

DO15 Paragraph BC88 sets out the Board's reasoning that the remeasurement component should be presented in other comprehensive income because 'although changes included in the remeasurements component may provide more information about the uncertainty and risk of future cash flows, they provide less information about the likely amount and timing of those cash flows'. Mr Yamada does not agree with that reasoning because, in his view, the actual return on plan assets provides information about the performance of plan assets during the period, but the disaggregation of the actual return into interest income and a remeasurements component does not provide information about the likely timing and amount of future cash flows. Therefore, in his view, it does not represent faithfully the performance of plan assets if the actual returns on plan assets in excess of the interest income on plan assets are presented in other comprehensive income and not presented in profit or loss when they occur. Instead, all the components should be presented in profit or loss when they occur. Therefore, he does not agree with paragraph 120(c). In his view the amount representing remeasurements does not have a clearly defined characteristic that justifies its presentation in other comprehensive income.

DO16 Mr Yamada notes that the definition of net interest on the net defined benefit liability (asset) results in the difference between the rate used to discount the defined benefit obligation applied to plan assets and the actual return on plan assets being presented in other comprehensive income. To do so eliminates from profit or loss the effects of differences between the actual return on plan assets and the rate applied to the defined benefit obligation. In his view the elimination of these differences introduces a type of smoothing mechanism. Thus, in his view the proposal is not an improvement on the previous version of IAS 19.

DO17 Given that the Board decided to present part of the defined benefit cost (ie remeasurements) in other comprehensive income, he is of the view that the Board should have retained the notion of actuarial gains and losses in the previous version of IAS 19 (paragraphs 93A–93D) rather than introduce a similar but not clearly better new notion of 'remeasurements'. This would mean that the expected return on plan assets is recognised in profit or loss and the difference between the expected return on plan assets and the actual return on plan assets is recognised in other comprehensive income. As stated in paragraph DO15, in Mr Yamada's view, this difference gives better information than the revised remeasurement component.

## Amendments to guidance on other IFRSs

*These amendments to guidance on IFRSs are necessary in order to ensure consistency with the amendments to* IAS 19*. In the amended paragraphs, new text is underlined and deleted text is struck through.*

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*The amendment contained in this appendix when IAS 19, as amended in 2011, was issued have been incorporated into the guidance and illustrative examples on the relevant Standards.*

## Table of concordance

This table shows how the contents of the superseded version of IAS 19 and IAS 19 as amended in 2011 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

| Superseded IAS 19 paragraph | IAS 19 (2011) paragraph |
|---|---|
| Objective | 1 |
| 1–6 | 2–7 |
| 7 | 8 |
| 8 | 9 |
| 9 | None |
| 10 | 11, 12 |
| 11–23 | 13–25 |
| 24 | 26 |
| 25 | 27, 28 |
| 26–28 | 29–31 |
| 29 | 32, 33 |
| 30 | 34 and 148 |
| 31 | 35 |
| 32 | 36 |
| 32A | 37 |
| 32B | None |
| 33 | 38 |
| 34–34B | 40–42 and 149 |
| 35 | Deleted in a previous amendment of IAS 19 |
| 36–38 | 43–45 |
| 39–42 | 46–49 |
| 43–47 | 50–54 |
| 48–50 | 55–57 |
| 51 | 60 |
| 52, 53 | 61, 62 |
| 54 | 63 |
| 55 | None |
| 56, 57 | 58, 59 |
| 58 | 64 |
| 58A, 58B | None |
| 59 | 65 |
| 60 | None |
| 61, 62 | 120, 121 |
| 63 | 66 |
| 64–66 | 67–69 |
| 67–71 | 70–74 |
| 72–77 | 75–80 |
| 78–81 | 83–86 |
| 82 | None |
| 83 | 87 |
| 84 | 90 |
| 85 | 88 |
| 86 | 89 |
| 87 | 95 |
| 88–90 | 96–98 |
| 91 | 92–94 |
| 92–93D | None |
| 94 | 128 |

| Superseded IAS 19 paragraph | IAS 19 (2011) paragraph |
|---|---|
| 95 | None |
| 96, 97 | None |
| 98 | 108 |
| 99, 100 | None |
| 101 | 107 |
| 102–104 | 113–115 |
| 104A–104D | 116–119 |
| 105, 106 | None |
| 107 | 130 |
| 108 | None |
| 109 | 109, 110 |
| 110 | 99 |
| 111 | 105 |
| 111A | None |
| 112 | 111 |
| 113 | 112 |
| 114 | 101 |
| 115 | None |
| 116–119 | 131–134 |
| 120 | 135 |
| 120A(a) | None |
| 120A(b) | 139(a) |
| 120A(c),(e),(g),(h) | 140, 141 |

| Superseded IAS 19 paragraph | IAS 19 (2011) paragraph |
|---|---|
| 120A(d) | 138 |
| 120A(f), (i) | None |
| 120A(j), (k) | 142, 143 |
| 120A(l), (m) | None |
| 120A(n) | 144 |
| 120A(o),(p) | None |
| 120A(q) | 147(b) |
| 121 | 139(a) |
| 122 | 138 |
| 123 | 148 |
| 124, 125 | 151, 152 |
| 126–131 | 153–158 |
| 132 | 159 |
| 133, 134 | 165–167 |
| 135 | 161 |
| 136 | 160 and 164 |
| 137 | None |
| 138 | 168 |
| 139, 141 | None |
| 142, 143 | 171 |
| 144–152 | Deleted in a previous amendment of IAS 19 |
| 153–161 | None |
| None | 10, 39, 81, 82, 91, 100, 102–104, 106, 122, 123–126, 127, 129, 136, 137, 139(b), 139(c), 145, 146, 147(a), 147(c), 150, 162, 163, 169, 170, 172, 173 |

HKAS 24 (Revised)
Revised ~~November 2014~~November 2016

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

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 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).**

**(viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting 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.**

(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 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.**

**17A If an entity obtains key management personnel services from another entity (the 'management entity'), the entity is not required to apply the requirements in paragraph 17 to the compensation paid or payable by the management entity to the management entity's employees or directors.**

**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.**

**<u>18A Amounts incurred by the entity for the provision of key management personnel services that are provided by a separate management entity shall be disclosed.</u>**

**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;

(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.

28B *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs 4 and 9. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

28C *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraph 9 and added paragraphs 17A and 18A. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

## Withdrawal of HKAS 24 (2004)

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

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.

## Key management personnel

BC50 The Board was asked to address the identification and disclosure of related party transactions that arise when a management entity provides key management personnel services to a reporting entity. The Board understood that divergence existed because some reporting entities do not identify this as a related party transaction. Of those who do identify this as a related party transaction, some reporting entities would disclose the compensation paid by the management entity to those employees or directors of the management entity that act as key management personnel of the reporting entity. Other reporting entities would disclose the service fee that is paid or payable to the management entity, which is incurred by the reporting entity.

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.

BC51 The Board noted that IAS 24 is unclear as to what information to disclose for key management personnel when those persons are not employees of the reporting entity. To address the diversity in disclosures that has arisen from IAS 24 being unclear, the Board decided to amend the definition of ‘related party’. The amendment clarified that a management entity that provides key management services to a reporting entity is deemed to be a related party of the reporting entity. In discussing these proposals, the Board acknowledged that the relationship between the management entity and the reporting entity is not symmetrical. The reporting entity is not a related party of the management entity solely as a consequence of being a customer of the management entity. The reporting entity cannot affect the management entity’s activities, financial position or profit except through some other relationship. Consequently, the reporting entity is required to disclose the amount incurred for the service fee paid or payable to the management entity that employs, or has as directors, the persons that provide the key management personnel services. As a result of identifying the management entity as a related party of the reporting entity, the Board noted that the reporting entity is also required to disclose other transactions with the management entity, for example, loans, under the existing disclosure requirements of IAS 24 with respect to related parties.

BC52 The Board was informed of concerns that it is impracticable to access the detailed information that is required in paragraph 17 when compensation is paid to a separate management entity as fees. The Board therefore decided to provide relief so that the reporting entity is not required to disclose the components of compensation to key management personnel that is paid through another entity. Instead, amounts incurred in respect of key management personnel compensation or key management personnel services, paid or payable to another entity, shall be disclosed in accordance with paragraph 18A.

HKAS 37
Revised ~~March 2010~~November 2016

Effective for annual periods
beginning on or after 1 January 2005

*Hong Kong Accounting Standard 37*

# Provisions, Contingent Liabilities and Contingent Assets

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# Hong Kong Accounting Standard 37
# *Provisions, Contingent Liabilities and Contingent Assets*

## Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

## Scope

**1 This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:**

**(a) those resulting from executory contracts, except where the contract is onerous;**

**(b)** [deleted]

**(c) those covered by another Standard.**

2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*.

3 Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

4 [Deleted]

5[*] When another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, some types of provisions are addressed in Standards on:

(a) construction contracts (see HKAS 11 *Construction Contracts*);

(b) income taxes (see HKAS 12 *Income Taxes)*;

(c) leases (see HKAS 17 *Leases*). However, as HKAS 17 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases;

(d) employee benefits (see HKAS 19 *Employee Benefits*); ~~and~~

(e) insurance contracts (see HKFRS 4 *Insurance Contracts*). However, this Standard applies to provisions, contingent liabilities and contingent assets of an insurer, other than those arising from its contractual obligations and rights under insurance contracts within the scope of HKFRS 4~~.~~; and

(f) contingent consideration of an acquirer in a business combination (see HKFRS 3 *Business Combinations*).

6 Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. HKAS 18 *Revenue* identifies the circumstances in which revenue is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of HKAS 18.

7 This Standard defines provisions as liabilities of uncertain timing or amount. In some countries the term "provision" is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

[*] Amendments effective for annual periods beginning on or after 1 July 2009.

97 [Not used]

98 [Not used]

99 *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraph 5 as a consequential amendment derived from the amendment to HKFRS 3. An entity shall apply that amendment prospectively to business combinations to which the amendment to HKFRS 3 applies.

HKAS 38
Revised ~~June 2014~~November 2016

Effective for annual periods
beginning on or after 1 January 2005

*Hong Kong Accounting Standard 38*

# Intangible Assets

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## Revaluation model

75 **After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be measured by reference to an active market. Revaluations shall be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.**

76 The revaluation model does not allow:

(a) the revaluation of intangible assets that have not previously been recognised as assets; or

(b) the initial recognition of intangible assets at amounts other than cost.

77 The revaluation model is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 65), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received by way of a government grant and recognised at a nominal amount (see paragraph 44).

78 It is uncommon for an active market to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.

79 The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

80 ~~If~~ When an intangible asset is revalued, ~~any accumulated amortisation~~ the carrying amount of that asset is adjusted to the revalued amount. A~~a~~t the date of the revaluation, the asset is ~~either~~ treated in one of the following ways:

(a) ~~restated proportionately~~ the gross carrying amount is adjusted in a manner that is consistent with the ~~change in the gross carrying amount of the asset so that~~ revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated amortisation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses ~~after revaluation equals its revalued amount~~; or

(b) the accumulated amortisation is eliminated against the gross carrying amount of the asset. ~~and the net amount restated to the revalued amount of the asset.~~

The amount of the adjustment of accumulated amortisation forms part of the increase or decrease in the carrying amount that is accounted for in accordance with paragraphs 85 and 86.

130A An entity shall apply the amendments in paragraph 2 for annual periods beginning on or after 1 January 2006. If an entity applies HKFRS 6 for an earlier period, those amendments shall be applied for that earlier period.

130B HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 85, 86 and 118(e)(iii). An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

130C HKFRS 3 (as revised in 2008) amended paragraphs 12, 33-35, 68, 69, 94 and 130, deleted paragraphs 38 and 129 and added paragraph 115A. *Improvements to HKFRSs* issued in May 2009 amended paragraphs 36 and 37. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. Therefore, amounts recognised for intangible assets and goodwill in prior business combinations shall not be adjusted. If an entity applies HKFRS 3 (revised 2008) for an earlier period, it shall apply the amendments for that earlier period and disclose the fact.

130D Paragraphs 69, 70 and 98 were amended and paragraph 69A 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.

130E [Deleted]

130F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 3(e). An entity shall apply that amendment when it applies HKFRS 10 and HKFRS 11.

130G HKFRS 13, issued in June 2011, amended paragraphs 8, 33, 47, 50, 75, 78, 82, 84, 100 and 124 and deleted paragraphs 39-41 and 130E. An entity shall apply those amendments when it applies HKFRS 13.

130H *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraph 80. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

130I An entity shall apply the amendment made by *Annual Improvements to HKFRSs 2010–2012 Cycle* to all revaluations recognised in annual periods beginning on or after the date of initial application of that amendment and in the immediately preceding annual period. An entity may also present adjusted comparative information for any earlier periods presented, but it is not required to do so. If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been presented on a different basis and explain that basis.

### Exchanges of similar assets

131 The requirement in paragraphs 129 and 130(b) to apply this Standard prospectively means that if an exchange of assets was measured before the effective date of this Standard on the basis of the carrying amount of the asset given up, the entity does not restate the carrying amount of the asset acquired to reflect its fair value at the acquisition date.

### Early application

**132 Entities to which paragraph 130 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 130. However, if an entity applies this Standard before those effective dates, it also shall apply HKFRS 3 and HKAS 36 at the same time.**

## Withdrawal of SSAP 29

133 This Standard supersedes SSAP 29 *Intangible Assets* (issued in 2001).

HKAS 38 BC
Revised ~~June 2014~~November 2016

*Basis for Conclusions on*
*Hong Kong Accounting Standard 38*

# Intangible Assets

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**DISSENTING OPINIONS**

**Amendments to Basis for Conclusions on IAS 16 and IAS 38**
***Clarification of Acceptable Methods of Depreciation and Amortisation***

## Accounting for intangible assets with indefinite useful lives (paragraphs 107-110)

BC73 Consistently with the proposals in the Exposure Draft, the Standard prohibits the amortisation of intangible assets with indefinite useful lives. Therefore, such assets are measured after initial recognition at:

(a) cost less any accumulated impairment losses; or

(b) a revalued amount, being fair value determined by reference to an active market* less any accumulated impairment losses.

### Non-amortisation

BC74 In developing the Exposure Draft and the revised Standard, the Board observed that many assets yield benefits to an entity over several periods. Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not be representationally faithful. Respondents to the Exposure Draft generally supported this conclusion.

BC75 Consequently, the Board decided that intangible assets with indefinite useful lives should not be amortised, but should be subject to regular impairment testing. The Board's deliberations on the form of the impairment test, including the frequency of impairment testing, are included in the Basis for Conclusions on IAS 36. The Board further decided that regular re-examinations should be required of the useful life of an intangible asset that is not being amortised to determine whether circumstances continue to support the assessment that the useful life is indefinite.

### Revaluations

BC76 Having decided that intangible assets with indefinite useful lives should not be amortised, the Board considered whether an entity should be permitted to carry such assets at revalued amounts. The Board could see no conceptual justification for precluding some intangible assets from being carried at revalued amounts solely on the basis that there is no foreseeable limit to the period over which an entity expects to consume the future economic benefits embodied in those assets.

BC77 As a result, the Board decided that the Standard should permit intangible assets with indefinite useful lives to be carried at revalued amounts.

* IFRS 13, issued in May 2011, defines an active market.

### Revaluation method—proportionate restatement of accumulated amortisation when an intangible asset is revalued

BC77A The IFRS Interpretations Committee reported to the Board that practice differed in calculating the accumulated depreciation for an item of property, plant and equipment that is measured using the revaluation method in cases in which the residual value, the useful life or the depreciation method has been re-estimated before a revaluation.

BC77B The reasons for making the change are further explained in paragraphs BC25A–BC25G of IAS 16.

BC77C The Board noted that the issue in paragraphs BC25A–BC25G of IAS 16 regarding accumulated depreciation upon revaluation could also occur when revaluing an intangible asset under IAS 38, because both IAS 16 and IAS 38 have the same requirements for accumulated depreciation/amortisation when revaluing items of property, plant and equipment/intangible assets. Differences in the revaluation models for items of property, plant and equipment and intangible assets do not result in different models for restating accumulated depreciation/amortisation. For example, IAS 38 requires that the fair value of an intangible asset is measured by reference to an active market. Otherwise, the revaluation model cannot be applied. However, IAS 38 requires fair value measurement by reference to an active market only for the carrying amount of an intangible asset in contrast to its gross carrying amount.

BC77D Consequently, the Board decided to amend paragraph 80(a) to state that:

(a) the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount; and

(b) the accumulated amortisation is calculated as the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses.

The Board also decided to amend paragraph 80(b) to be consistent with the wording used in those amendments.

BC77E The Board decided to include wording in paragraph 80(a) to require an entity to take into account accumulated impairment losses when adjusting the amortisation on revaluation. This was to ensure that when future revaluation increases occur, the correct split according to paragraph 85 of IAS 38 and paragraph 119 of IAS 36 is made between profit or loss and other comprehensive income when reversing prior accumulated impairment losses.

## Research and development projects acquired in business combinations

BC78 The Board considered the following issues in relation to in-process research and development (IPR&D) projects acquired in a business combination:

(a) whether the proposed criteria for recognising intangible assets acquired in a business combination separately from goodwill should also be applied to IPR&D projects;

## Revaluation method—proportionate restatement of accumulated amortisation when an intangible asset is revalued

BC100A *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, amended paragraph 80. The Board also decided that the amendment should be required to be applied to all revaluations occurring in annual periods beginning on or after the date of initial application of the amendment and in the immediately preceding annual period. The Board was concerned that the costs of full retrospective application might outweigh the benefits.

*Hong Kong Accounting Standard 39*

# Financial Instruments:

# Recognition and Measurement

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# Definitions

8 The terms defined in HKAS 32 are used in this Standard with the meanings specified in paragraph 11 of HKAS 32. HKAS 32 defines the following terms:

- financial instrument
- financial asset
- financial liability
- equity instrument

and provides guidance on applying those definitions.

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

**Definition of a derivative**

**A** *derivative* **is a financial instrument or other contract within the scope of this Standard (see paragraphs 2-7) with all three of the following characteristics:**

**(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');**

**(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and**

**(c) it is settled at a future date.**

**Definitions of four categories of financial instruments**

**A** *financial asset* **or** *financial liability at fair value through profit or loss* **is a financial asset or financial liability that meets ~~either~~ any of the following conditions.**

**(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if:**

**(i) it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;**

**(ii) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or**

**(iii) it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).**

**(aa) It is contingent consideration of an acquirer in a business combination to which HKFRS 3 *Business Combinations* applies.**

**(b) Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either**

108C Paragraphs 9, 73 and AG8 were amended and paragraph 50A added by *Improvements to HKFRSs* issued in October 2008. Paragraph 80 was amended by *Improvements to HKFRSs* issued in May 2009. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. An entity shall apply the amendments in paragraphs 9 and 50A as of the date and in the manner it applied the 2005 amendments described in paragraph 105A. Earlier application of all the amendments is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

108D *Novation of Derivatives and Continuation of Hedge Accounting* (Amendments to HKAS 39), issued in July 2013, amended paragraphs 91 and 101 and added paragraph AG113A. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2014. An entity shall apply those amendments retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

108E [Not used]

108F *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraph 9 as a consequential amendment derived from the amendment to HKFRS 3. An entity shall apply that amendment prospectively to business combinations to which the amendment to HKFRS 3 applies.

## Withdrawal of other pronouncements

109 This Standard supersedes SSAP 24 *Accounting for Investments in Securities*.

HKAS 39 BC
Revised November ~~2014~~2016

*Basis for Conclusions*
*Hong Kong Accounting Standard 39*

# Financial Instruments:

# Recognition and Measurement

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### Measurement of financial liabilities with a demand feature*

BC93 – BC94 [Deleted]

## Fair value measurement guidance (paragraphs AG69-AG82)#

BC95 The Board decided to include in the revised IAS 39 expanded guidance about how to determine fair values, in particular for financial instruments for which no quoted market price is available (Appendix A paragraphs AG74-AG82).† The Board decided that it is desirable to provide clear and reasonably detailed guidance about the objective and use of valuation techniques to achieve reliable and comparable fair value estimates when financial instruments are measured at fair value.

### Use of quoted prices in active markets (paragraphs AG71-AG73)

BC96 The Board considered comments received that disagreed with the proposal in the Exposure Draft that a quoted price is the appropriate measure of fair value for an instrument quoted in an active market. Some respondents argued that (a) valuation techniques are more appropriate for measuring fair value than a quoted price in an active market (eg for derivatives) and (b) valuation models are consistent with industry best practice, and are justified because of their acceptance for regulatory capital purposes.

BC97 However, the Board confirmed that a quoted price is the appropriate measure of fair value for an instrument quoted in an active market, notably because (a) in an active market, the quoted price is the best evidence of fair value, given that fair value is defined in terms of a price agreed by a knowledgeable, willing buyer and a knowledgeable, willing seller; (b) it results in consistent measurement across entities; and (c) fair value as defined in the Standard does not depend on entity-specific factors. The Board further clarified that a quoted price includes market-quoted rates as well as prices.

* IFRS 13, issued in May 2011, resulted in the relocation of paragraphs BC93 and BC94 of IAS 39 to paragraphs BCZ102 and BCZ103 of IFRS 13. As a consequence minor necessary edits have been made to that material.

# IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

† IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence in Appendix A of IAS 39 paragraphs AG69-AG75, AG76A-AG79 and AG82 have been deleted and paragraphs AG76, AG80 and AG81 have been amended. *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, added paragraph BC138A to the Basis for Conclusions on IFRS 13 to clarify the IASB's reason for deleting paragraph AG79.

HKAS 40
Revised ~~June 2014~~November 2016

*Hong Kong Accounting Standard 40*

# Investment Property

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**APPENDIX:**

**Comparison with International Accounting Standards**

**IASB BASIS FOR CONCLUSIONS ON IAS 40 (AS REVISED IN 2003)**

**IASC BASIS FOR CONCLUSIONS ON IAS 40 (2000)**

Hong Kong Accounting Standard 40 *Investment Property* (HKAS 40) is set out in paragraphs 1-86. All the paragraphs have equal authority. HKAS 40 should be read in the context of its objective and the IASB's 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.

**(b) sale in the ordinary course of business.**

*Owner-occupied property* **is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.**

## Classification of property as investment property or owner-occupied property

**6 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 33-55 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 74-78.**

7 Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process. HKAS 16 *Property, Plant and Equipment* applies to owner-occupied property.

8 The following are examples of investment property:

(a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.

(b) land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)

(c) a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.

(d) a building that is vacant but is held to be leased out under one or more operating leases.

(e) property that is being constructed or developed for future use as investment property.

9 The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

(a) property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see HKAS 2 *Inventories*), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.

(b) property being constructed or developed on behalf of third parties (see HKAS 11 *Construction Contracts*).

(c) owner-occupied property (see HKAS 16), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.

(d) [deleted]

(e) property that is leased to another entity under a finance lease.

10 Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

11 In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.

12 In other cases, the services provided are significant. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.

13 It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, the owner of a hotel sometimes transfers some responsibilities to third parties under a management contract. The terms of such contracts vary widely. At one end of the spectrum, the owner's position may, in substance, be that of a passive investor. At the other end of the spectrum, the owner may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.

14 Judgement is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7-13. Paragraph 75(c) requires an entity to disclose these criteria when classification is difficult.

14A Judgement is also needed to determine whether the acquisition of investment property is the acquisition of an asset or a group of assets or a business combination within the scope of HKFRS 3 *Business Combinations*. Reference should be made to HKFRS 3 to determine whether it is a business combination. The discussion in paragraphs 7–14 of this Standard relates to whether or not property is owner-occupied property or investment property and not to determining whether or not the acquisition of property is a business combination as defined in HKFRS 3. Determining whether a specific transaction meets the definition of a business combination as defined in HKFRS 3 and includes an investment property as defined in this Standard requires the separate application of both Standards.

15 In some cases, an entity owns property that is leased to, and occupied by, its parent or another subsidiary. The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group. However, from the perspective of the entity that owns it, the property is investment property if it meets the definition in paragraph 5. Therefore, the lessor treats the property as investment property in its individual financial statements.

# Recognition

**16 Investment property shall be recognised as an asset when, and only when:**

**(a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and**

**(b) the cost of the investment property can be measured reliably.**

17 An entity evaluates under this recognition principle all its investment property costs at the time they are incurred. These costs include costs incurred initially to acquire an investment property and costs incurred subsequently to add to, replace part of, or service a property.

18 Under the recognition principle in paragraph 16, an entity does not recognise in the carrying amount of an investment property the costs of the day-to-day servicing of such a property. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the cost of labour and consumables, and may include the cost of minor parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the property.

19 Parts of investment properties may have been acquired through replacement. For example, the interior walls may be replacements of original walls. Under the recognition principle, an entity recognises in the carrying amount of an investment property the cost of replacing part of an existing investment property at the time 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.

### Business Combinations

**84A** ***Annual Improvements Cycle 2011–2013*** **issued in January 2014 added paragraph 14A and a heading before paragraph 6. An entity shall apply that amendment prospectively for acquisitions of investment property from the beginning of the first period for which it adopts that amendment. Consequently, accounting for acquisitions of investment property in prior periods shall not be adjusted. However, an entity may choose to apply the amendment to individual acquisitions of investment property that occurred prior to the beginning of the first annual period occurring on or after the effective date if, and only if, information needed to apply the amendment to those earlier transactions is available to the entity.**

## Effective date

**85** **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.**

85a 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).

**85A** **HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 62. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.**

85B Paragraphs 8, 9, 48, 53, 54 and 57 were amended, paragraph 22 was deleted and paragraphs 53A and 53B were added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2009. An entity is permitted to apply the amendments to investment property under construction from any date before 1 January 2009 provided that the fair values of investment properties under construction were measured at those dates. 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 amendments to paragraphs 5 and 81E of HKAS 16 *Property, Plant and Equipment*.

85C HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 5, amended paragraphs 26, 29, 32, 40, 48, 53, 53B, 78-80 and 85B and deleted paragraphs 36-39, 42-47, 49, 51 and 75(d). An entity shall apply those amendments when it applies HKFRS 13.

85D *Annual Improvements Cycle 2011–2013* issued in January 2014 added headings before paragraph 6 and after paragraph 84 and added paragraphs 14A and 84A. An entity shall apply those amendments for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

## Withdrawal of SSAP 13

86 This Standard supersedes SSAP 13 Accounting for Investment Properties (revised in 2000).

## Scope

### Investment property under construction

BC15 In response to requests for guidance, the Board revisited the exclusion of investment property under construction from the scope of IAS 40. The Board noted that investment property being redeveloped remained in the scope of this Standard and that the exclusion of investment property under construction gave rise to a perceived inconsistency. In addition, the Board concluded that with increasing experience with the use of fair value measures since the Standard was issued, entities were more able to measure reliably the fair value of investment property under construction. Therefore, in the exposure draft of *Improvements to International Financial Reporting Standards* published in 2007 the Board proposed amending the scope of the Standard to include investment property under construction.

BC16 Many respondents supported the Board's proposal. However, many expressed concern that including in IAS 40 investment property under construction might result in fewer entities measuring investment property at fair value. This was because the fair value model in the Standard requires an entity to establish whether fair value can be determined reliably when a property first becomes an investment property. If not, the property is accounted for using the cost model until it is disposed of. In some situations, the fair value of investment property under construction cannot be measured reliably but the fair value of the completed investment property can. In these cases, including in the Standard investment property under construction would have required the properties to be accounted for using the cost model even after construction had been completed.

BC17 Therefore, the Board concluded that, in addition to including investment property under construction within the scope of the Standard, it would also amend the Standard to allow investment property under construction to be measured at cost if fair value cannot be measured reliably until such time as the fair value becomes reliably measurable or construction is completed (whichever comes earlier).

## Classification of property as investment property or owner-occupied property

### Acquisition of investment property: interrelationship with IFRS 3

BC18 The IFRS Interpretations Committee (the 'Interpretations Committee') reported to the Board that practice differed in delineating the scope of IFRS 3 *Business Combinations* and IAS 40:

(a) some considered both Standards as mutually exclusive if investment property with associated insignificant ancillary services, as specified in paragraph 11 of IAS 40, is acquired. They view property, together with any associated insignificant ancillary services, as being a single 'unit of account' and they consider this unit of account to be one asset called 'investment property'.

(b) others did not view IFRS 3 and IAS 40 as being mutually exclusive if investment property with associated insignificant ancillary services, as specified in paragraph 11 of IAS 40, is acquired; nor did they view the definitions of a business as defined in Appendix A of IFRS 3 and investment property as defined in paragraph 5 of IAS 40 as being interrelated. They think that an entity that acquires investment property has to determine whether it meets both definitions.

BC19 The Board noted that paragraphs 7–14 of IAS 40 have been developed to differentiate investment property from owner-occupied property and to define the scope of IAS 40 to distinguish it from the scope of IAS 16 *Property, Plant and Equipment*. In addition, neither IFRS 3 nor IAS 40 contains a limitation in its scope that restricts its application when the other Standard applies, ie there is nothing within the scope of each Standard to suggest that they are mutually exclusive. The Board also noted that the wording of IAS 40 is not sufficiently clear about the interrelationship between the two Standards.

BC20 The Board agreed with the proponents of the view presented in paragraph BC18(b) that IFRS 3 and IAS 40 are not mutually exclusive. It amended IAS 40 to state explicitly that judgement is also needed to determine whether the transaction is the acquisition of an asset or a group of assets or is a business combination within the scope of IFRS 3. That judgement is not based on paragraphs 7–14 of IAS 40 but is instead based on the guidance in IFRS 3. Only the judgement needed to distinguish investment property from owner-occupied property is based on those paragraphs.

BC21 Consequently, the Board clarified the interrelationship between the two Standards by adding paragraph 14A and a heading before paragraph 6 to IAS 40.

## Effective date and transition

BC22 *Annual Improvements Cycle 2011–2013* issued in December 2013 added headings before paragraph 6 and after paragraph 84 and added paragraphs 14A, 84A and 85D to clarify the interrelationship between IFRS 3 and IAS 40. It considered the provisions for transition and the effective date of the amendment to IAS 40. The Board noted that applying IFRS 3 to transactions that have previously been accounted for as the acquisition of an asset or a group of assets might involve the use of hindsight when determining the fair values, at acquisition date, of the identifiable assets acquired and of the liabilities assumed as part of the business combination transaction. However, it also noted that the amendment is only a clarification of the interrelationship between IFRS 3 and IAS 40. Consequently, it decided that an entity would apply the amendments to IAS 40 prospectively for annual periods beginning on or after 1 July 2014, but an entity may choose to apply the amendment to individual transactions that occurred prior to the beginning of the first annual period occurring on or after the effective date only if the information needed is available to the entity.

HKFRS 1 (Revised)
Revised November ~~2014~~ 2016

Effective for annual periods
beginning on or after 1 July 2009

*Hong Kong Financial Reporting Standards 1 (Revised)*

# First-time Adoption of Hong Kong Financial Reporting Standards

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D3 A first-time adopter is encouraged, but not required, to apply HKFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to HKFRSs. A first-time adopter is also encouraged, but not required, to apply HKFRS 2 to liabilities that were settled before 1 January 2005. For liabilities to which HKFRS 2 is applied, a first-time adopter is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002.

## Insurance contracts

D4 A first-time adopter may apply the transitional provisions in HKFRS 4 *Insurance Contracts*. HKFRS 4 restricts changes in accounting policies for insurance contracts, including changes made by a first-time adopter.

## Deemed cost

D5 An entity may elect to measure an item of property, plant and equipment at the date of transition to HKFRSs at its fair value and use that fair value as its deemed cost at that date.

D6 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to HKFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) fair value; or

(b) cost or depreciated cost in accordance with HKFRSs, adjusted to reflect, for example, changes in a general or specific price index.

D7 The elections in paragraphs D5 and D6 are also available for:

(a) investment property, if an entity elects to use the cost model in HKAS 40 *Investment Property,* and

(b) intangible assets that meet:

(i) the recognition criteria in HKAS 38 (including reliable measurement of original cost); and

(ii) the criteria in HKAS 38 for revaluation (including the existence of an active market).

An entity shall not use these elections for other assets or for liabilities.

D8 A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering.

(a) If the measurement date is *at or before* the date of transition to HKFRSs, the entity may use such event-driven fair value measurements as deemed cost for HKFRSs at the date of that measurement.

(b) If the measurement date is *after* the date of transition to HKFRSs, but during the period covered by the first HKFRS financial statements, the event-driven fair value measurements may be used as deemed cost when the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or if appropriate, another category of equity) at the measurement date. At the date of transition to HKFRSs, the entity shall either establish the deemed cost by applying the criteria in paragraphs D5–D7 or measure assets and liabilities in accordance with the other requirements in this HKFRS.

HKFRS 1 (Revised) BC
Revised November ~~2014~~ 2016

Effective for annual periods
beginning on or after 1 July 2009

*Basis for Conclusions on*
*Hong Kong Financial Reporting Standards 1 (Revised)*

# First-time Adoption of Hong Kong Financial Reporting Standards

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## Current version of IFRSs

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions[†]. This:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC11A Paragraph 7 requires an entity to use the IFRSs that are effective at the end of its first IFRS reporting period. Paragraph 8 allows a first-time adopter to apply a new IFRS that is not yet mandatory if that IFRS permits early application. Notwithstanding the advantages, set out in paragraph BC11, of applying a more recent version of an IFRS, paragraphs 7–8 permit an entity to use either the IFRS that is currently mandatory or the new IFRS that is not yet mandatory, if that new IFRS permits early application. Paragraph 7 requires an entity to apply the same version of the IFRS throughout the periods covered by the entity's first IFRS financial statements. Consequently, if a first-time adopter chooses to early apply a new IFRS, that new IFRS will be applied throughout all the periods presented in its first IFRS financial statements on a retrospective basis, unless IFRS 1 provides an exemption or an exception that permits or requires otherwise.

BC12 In general, the transitional provisions in other IFRSs do not apply to a first-time adopter (paragraph 9 of the IFRS). Some of these transitional provisions require or permit an entity already reporting in accordance with IFRSs to apply a new requirement prospectively. These provisions generally reflect a conclusion that one or both of the following factors are present in a particular case:

(a) Retrospective application may be difficult or involve costs exceeding the likely benefits. The IFRS permits prospective application in specific cases where this could occur (paragraphs BC30–BC73).

(b) There is a danger of abuse if retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. The IFRS prohibits retrospective application in some areas where this could occur (paragraphs BC74–BC84).

BC13 Some have suggested three further reasons for permitting or requiring prospective application in some cases:

(a) to alleviate unforeseen consequences of a new IFRS if another party uses financial statements to monitor compliance with a contract or agreement. However, in the Board's view, it is up to the parties to an agreement to determine whether to insulate the agreement from the effects of a future IFRS and, if not, how they might renegotiate it so that it reflects changes in the underlying financial condition rather than changes in reporting (paragraph 21* of the *Preface to International Financial Reporting Standards*).

† *Annual Improvements Cycle 2011–2013* clarified that this paragraph does not require an entity to use a more recent version of an IFRS. It only explains the advantages of applying a more recent version of an IFRS. See paragraph BC11A for further details.

* amended to paragraph 20 when the *Preface* was revised in January 2010.

(b) to give a first-time adopter the same accounting options as an entity that already applies IFRSs. However, permitting prospective application by a first-time adopter would conflict with the Board's primary objective of comparability within an entity's first IFRS financial statements (paragraph BC10). Therefore, the Board did not adopt a general policy of giving first-time adopters the same accounting options of prospective application that existing IFRSs give to entities that already apply IFRSs. Paragraphs BC20–BC23 discuss one specific case, namely derecognition of financial assets and financial liabilities.

(c) to avoid difficult distinctions between changes in estimates and changes in the basis for making estimates. However, a first-time adopter need not make this distinction in preparing its opening IFRS balance sheet, so the IFRS does not include exemptions on these grounds. If an entity becomes aware of errors made under previous GAAP, the IFRS requires it to disclose the correction of the errors (paragraph 26 of the IFRS).

BC14 The Board will consider case by case when it issues a new IFRS whether a first-time adopter should apply that IFRS retrospectively or prospectively. The Board expects that retrospective application will be appropriate in most cases, given its primary objective of comparability over time within a first-time adopter's first IFRS financial statements. However, if the Board concludes in a particular case that prospective application by a first-time adopter is justified, it will amend the IFRS on first-time adoption of IFRSs. As a result, IFRS 1 will contain all material on first-time adoption of IFRSs and other IFRSs will not refer to first-time adopters (except, when needed, in the Basis for Conclusions and consequential amendments).

HKFRS 2
Revised ~~August~~ November 2016

Effective for annual periods beginning on or after 1 January 2005

*Hong Kong Financial Reporting Standard 2*

# Share-based Payment

CPA

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13 To apply the requirements of paragraph 10 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the entity obtains the goods or the counterparty renders service. In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service.

13A In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with this HKFRS. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

## Transactions in which services are received

14 If the equity instruments granted *vest* immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity.

15 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:

(a) if an employee is granted share options conditional upon completing three years' service, then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period.

(b) if an employee is granted share options conditional upon the achievement of a ~~performance condition~~ *performance condition* and remaining in the entity's employ until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. The entity shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a *market condition*, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted, and shall not be subsequently revised. If the performance condition is not a market condition, the entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates.

## Transactions measured by reference to the fair value of the equity instruments granted

### Determining the fair value of equity instruments granted

16 For transactions measured by reference to the fair value of the equity instruments granted, an entity shall measure the fair value of equity instruments granted at the *measurement date*, based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted (subject to the requirements of paragraphs 19–22).

17 If market prices are not available, the entity shall estimate the fair value of the equity instruments granted using a valuation technique to estimate what the price of those equity instruments would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties. The valuation technique shall be consistent with generally accepted valuation methodologies for pricing financial instruments, and shall incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price (subject to the requirements of paragraphs 19–22).

18 Appendix B contains further guidance on the measurement of the fair value of shares and share options, focusing on the specific terms and conditions that are common features of a grant of shares or share options to employees.

### Treatment of vesting conditions

19 A grant of equity instruments might be conditional upon satisfying specified ~~vesting conditions~~vesting conditions. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a ~~*vesting condition*~~*vesting condition*, e.g. the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21.

(b) the revised definitions of 'vest' and 'vesting conditions' in Appendix A;

(c) the amendments in paragraphs 28 and 28A in respect of cancellations.

Earlier application is permitted. If an entity applies these amendments for a period beginning before 1 January 2009, it shall disclose that fact.

63 An entity shall apply the following amendments made by *Group Cash-settled Share-based Payment Transactions* issued in July 2009 retrospectively, subject to the transitional provisions in paragraphs 53–59, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2010:

(a) the amendment of paragraph 2, the deletion of paragraph 3 and the addition of paragraphs 3A and 43A–43D and of paragraphs B45, B47, B50, B54, B56–B58 and B60 in Appendix B in respect of the accounting for transactions among group entities.

(b) the revised definitions in Appendix A of the following terms:

- cash-settled share-based payment transaction,
- equity-settled share-based payment transaction,
- share-based payment arrangement, and
- share-based payment transaction.

If the information necessary for retrospective application is not available, an entity shall reflect in its separate or individual financial statements the amounts previously recognised in the group's consolidated financial statements. Earlier application is permitted. If an entity applies the amendments for a period beginning before 1 January 2010, it shall disclose that fact.

63A HKFRS 10 *Consolidated Financial Statements* and HKFRS 11, issued in June 2011, amended paragraph 5 and Appendix A. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

63B *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraphs 15 and 19. In Appendix A, the definitions of 'vesting conditions' and 'market condition' were amended and the definitions of 'performance condition' and 'service condition' were added. An entity shall prospectively apply that amendment to share-based payment transactions for which the grant date is on or after 1 July 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

## Withdrawal of Interpretations

64 *Group Cash-settled Share-based Payment Transactions* issued in July 2009 supersedes HK(IFRIC)-Int 8 *Scope of HKFRS 2* and HK(IFRIC)-Int 11 *HKFRS 2—Group and Treasury Share Transactions*. The amendments made by that document incorporated the previous requirements set out in HK(IFRIC)-Int 8 and HK(IFRIC)-Int 11 as follows:

(a) amended paragraph 2 and added paragraph 13A in respect of the accounting for transactions in which the entity cannot identify specifically some or all of the goods or services received. Those requirements were effective for annual periods beginning on or after 1 May 2006.

(b) added paragraphs B46, B48, B49, B51–B53, B55, B59 and B61 in Appendix B in respect of the accounting for transactions among group entities. Those requirements were effective for annual periods beginning on or after 1 March 2007.

Those requirements were applied retrospectively in accordance with the requirements of HKAS 8, subject to the transitional provisions of HKFRS 2.

**grant date**

The date at which the entity and another party (including an employee) agree to a **share-based payment arrangement**, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or **equity instruments** of the entity, provided the specified **vesting conditions**, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

**intrinsic value**

The difference between the **fair value** of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a **share option** with an exercise price of CU15,[*] on a share with a **fair value** of CU20, has an intrinsic value of CU5.

**market condition**

A **performance condition** ~~condition~~ upon which the exercise price, vesting or exercisability of an **equity instrument** depends that is related to the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group), such as:

(a) attaining a specified share price or a specified amount of **intrinsic value** of a **share option**~~,~~; or

(b) achieving a specified target that is based on the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group) relative to an index of market prices of **equity instruments** of other entities.

A market condition requires the counterparty to complete a specified period of service (ie a **service condition**); the service requirement can be explicit or implicit.

**measurement date**

The date at which the **fair value** of the **equity instruments granted** is measured for the purposes of this HKFRS. For transactions with **employees and others providing similar services**, the measurement date is **grant date**. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

[*] In this appendix, monetary amounts are denominated in 'currency units' (CU).

**performance condition**

A **vesting condition** that requires:

(a) the counterparty to complete a specified period of service (ie a **service condition**); the service requirement can be explicit or implicit; and

(b) specified performance target(s) to be met while the counterparty is rendering the service required in (a).

The period of achieving the performance target(s):

(a) shall not extend beyond the end of the service period; and

(b) may start before the service period on the condition that the commencement date of the performance target is not substantially before the commencement of the service period.

A performance target is defined by reference to:

(a) the entity's own operations (or activities) or the operations or activities of another entity in the same group (ie a non-market condition); or

(b) the price (or value) of the entity's **equity instruments** or the equity instruments of another entity in the same group (including shares and **share options**) (ie a **market condition**).

A performance target might relate either to the performance of the entity as a whole or to some part of the entity (or part of the group), such as a division or an individual employee.

**reload feature**

A feature that provides for an automatic grant of additional **share options** whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

**reload option**

A new **share option** granted when a share is used to satisfy the exercise price of a previous **share option**.

**service condition**

A **vesting condition** that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the **vesting period**, it has failed to satisfy the condition. A service condition does not require a performance target to be met.

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| **share-based payment arrangement** | An agreement between the entity (or another group[(a)] entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive<br><br>(a) cash or other assets of the entity for amounts that are based on the price (or value) of **equity instruments** (including shares or **share options**) of the entity or another group entity, or<br><br>(b) equity instruments (including shares or share options) of the entity or another group entity,<br><br>provided the specified **vesting conditions**, if any, are met. |
| **share-based payment transaction** | A transaction in which the entity<br><br>(a) receives goods or services from the supplier of those goods or services (including an employee) in a **share-based payment arrangement**, or<br><br>(b) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services. |
| **share option** | A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time. |
| **vest** | To become an entitlement. Under a **share-based payment arrangement**, a counterparty's right to receive cash, other assets or **equity instruments** of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any **vesting conditions**. |
| **vesting condition~~s~~** | ~~The~~ A condition~~s~~ that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or **equity instruments** of the entity, under a **share-based payment arrangement**. A v~~V~~esting condition~~s~~ ~~are~~ is either ~~service conditions~~ a **service condition** or ~~performance conditions~~ a **performance condition**. ~~Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time). A performance condition might include a **market condition**.~~ |
| **vesting period** | The period during which all the specified **vesting conditions** of a **share-based payment arrangement** are to be satisfied. |

(a) A 'group' is defined in Appendix A of HKFRS 10 *Consolidated Financial Statements* as 'a parent and its subsidiaries' from the perspective of the reporting entity's ultimate parent.

## Share-based payment transactions with a net settlement feature for withholding tax obligations

33E Tax laws or regulations may oblige an entity to withhold an amount for an employee’s tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee’s behalf. To fulfil this obligation, the terms of the share-based payment arrangement may permit or require the entity to withhold the number of equity instruments equal to the monetary value of the employee’s tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment (ie the share-based payment arrangement has a ‘net settlement feature’).

33F As an exception to the requirements in paragraph 34, the transaction described in paragraph 33E shall be classified in its entirety as an equity-settled share-based payment transaction if it would have been so classified in the absence of the net settlement feature.

33G The entity applies paragraph 29 of this Standard to account for the withholding of shares to fund the payment to the tax authority in respect of the employee's tax obligation associated with the share-based payment. Therefore, the payment made shall be accounted for as a deduction from equity for the shares withheld, except to the extent that the payment exceeds the fair value at the net settlement date of the equity instruments withheld.

33H The exception in paragraph 33F does not apply to:

(a) a share-based payment arrangement with a net settlement feature for which there is no obligation on the entity under tax laws or regulations to withhold an amount for an employee’s tax obligation associated with that share-based payment; or

(b) any equity instruments that the entity withholds in excess of the employee’s tax obligation associated with the share-based payment (ie the entity withheld an amount of shares that exceeds the monetary value of the employee’s tax obligation). Such excess shares withheld shall be accounted for as a cash-settled share-based payment when this amount is paid in cash (or other assets) to the employee.

## Share-based payment transactions with cash alternatives

**34 For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.**

## Disclosures

…

52 If the information required to be disclosed by this ~~HKFRS~~ Standard does not satisfy the principles in paragraphs 44, 46 and 50, the entity shall disclose such additional information as is necessary to satisfy them. For example, if an entity has classified any share-based payment transactions as equity-settled in accordance with paragraph 33F, the entity shall disclose an estimate of the amount that it expects to transfer to the tax authority to settle the employee’s tax obligation when it is necessary to

HKFRS 2 BC
Revised ~~August~~ November 2016

*Basis for Conclusions on*
*Hong Kong Financial Reporting Standard 2*

# Share-based Payment

Hong Kong Institute of
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| | |
|---|---|
| **SHARE-BASED PAYMENT TRANSACTIONS WITH CASH ALTERNATIVES** | **BC256** |
| **The terms of the arrangement provide the employee with a choice of settlement** | **BC258** |
| **The terms of the arrangement provide the entity with a choice of settlement** | **BC265** |
| **SHARE-BASED PAYMENT TRANSACTIONS AMONG GROUP ENTITIES (2009 AMENDMENTS)** | **BC268A** |
| **Transfer of employees between group entities** | **BC268P** |
| **OVERALL CONCLUSIONS ON ACCOUNTING FOR EMPLOYEE SHARE OPTIONS** | **BC269** |
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| **Share-based payment transactions among group entities** | **BC310A** |
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| **Accounting for own shares held** | **BC330** |
| **DEFINITION OF VESTING CONDITION (2013 AMENDMENTS)** | **BC334** |
| **Whether a performance target can be set by reference to the price (or value) of another entity (or entities) that is (are) within the group** | **BC337** |
| **Whether a performance target that refers to a longer period than the required service period may constitute a performance condition** | **BC339** |
| **Whether the specified period of service that the counterparty is required to complete can be either implicit or explicit** | **BC346** |
| **Whether a performance target needs to be influenced by an employee** | **BC347** |
| **Whether a share market index target may constitute a performance condition or a non-vesting condition** | **BC353** |

**Whether the definition of performance condition should indicate that it includes a market condition** **BC359**

**Whether a definition of 'non-vesting condition' is needed** **BC362**

**Whether the employee's failure to complete a required service period due to termination of employment is considered to be a failure to satisfy a service condition** **BC365**

**Transition provisions** **BC370**

**APPENDIX**

**A** **Basis for Conclusions on the amendments to IFRS 2** ***Classification and Measurement of Share-based Payment Transactions***

BC331 This is consistent with the *Framework*. The repurchase of shares and their subsequent reissue or transfer to other parties are transactions with equity participants that should be recognised as changes in equity. In accounting terms, there is no difference between shares that are repurchased and cancelled, and shares that are repurchased and held by the entity. In both cases, the repurchase involves an outflow of resources to shareholders (i.e. a distribution), thereby reducing shareholders' investment in the entity. Similarly, there is no difference between a new issue of shares and an issue of shares previously repurchased and held in treasury. In both cases, there is an inflow of resources from shareholders, thereby increasing shareholders' investment in the entity. Although accounting practice in some jurisdictions treats own shares held as assets, this is not consistent with the definition of assets in the *Framework* and the conceptual frameworks of other standard-setters, as explained in the Discussion Paper (footnote to paragraph 4.7 of the Discussion Paper, reproduced earlier in the footnote to paragraph BC73).

BC332 Given that treasury shares are treated as an asset in some jurisdictions, it will be necessary to change that accounting treatment when this IFRS is applied, because otherwise an entity would be faced with two expense items—an expense arising from the share-based payment transaction (for the consumption of goods and services received as consideration for the issue of an equity instrument) and another expense arising from the write-down of the 'asset' for treasury shares issued or transferred to employees at an exercise price that is less than their purchase price.

BC333 Hence, the Board concluded that the requirements in the relevant paragraphs of IAS 32 regarding treasury shares should also be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share plans or other share-based payment arrangements.

## Definition of vesting condition (2013 amendments)

BC334 The Board decided to clarify the definition of 'vesting conditions' in IFRS 2 to ensure the consistent classification of conditions attached to a share-based payment. Previously, this Standard did not separately define 'performance condition' or 'service condition', but instead described both concepts within the definition of vesting conditions.

BC335 The Board decided to separate the definitions of performance condition and service condition from the definition of vesting condition to make the description of each condition clearer.

BC336 In response to the comments received on the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle* (Proposed amendments to International Financial Reporting Standards) (the 'ED'), published in May 2012, the Board addressed the following concerns that had been raised about the definitions of performance condition, service condition and market condition:

(a) whether a performance target can be set by reference to the price (or value) of another entity (or entities) that is (are) within the group;

(b) whether a performance target that refers to a longer period than the required service period may constitute a performance condition;

(c) whether the specified period of service that the counterparty is required to complete can be either implicit or explicit;

(d) whether a performance target needs to be influenced by an employee;

(e) whether a share market index target may constitute a performance condition or a non-vesting condition;

(f) whether the definition of performance condition should indicate that it includes a market condition;

(g) whether a definition of non-vesting condition is needed; and

(h) whether the employee's failure to complete a required service period due to termination of employment is considered to be a failure to satisfy a service condition.

## Whether a performance target can be set by reference to the price (or value) of another entity (or entities) that is (are) within the group

BC337 The Board decided to clarify that within the context of a share-based payment transaction that involves entities in the same group, a performance target can be defined by the price (or value) of the equity instruments of another entity in that group. This amendment is consistent with the guidance in paragraphs 3A and 43A–43D of IFRS 2. Paragraph 3A, which provides guidance about the scope of IFRS 2, states that "a share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services".

BC338 The Board decided to make a similar amendment to the definition of market condition to indicate that a market condition can be based on the market price of the entity's equity instruments or the equity instruments of another entity in the same group.

## Whether a performance target that refers to a longer period than the required service period may constitute a performance condition

BC339 The Board observed that IFRS 2 was not clear about the duration of a performance target relative to the duration of the related service condition. Some understood IFRS 2 to require that the duration of the performance has to be wholly within the period of the related service requirement; others understood that a performance target could be achieved over a period that extends beyond the period for which the employee is required to provide a service.

BC340 During its deliberations prior to the issue of the ED, the Board decided to clarify that the duration of the performance condition needed to be wholly within the period of the related service requirement. This meant that the period of achieving the performance target could not start before, or end after, the service period. This requirement was reflected in the ED.

BC341 Some respondents to the ED disagreed with the requirement that the duration of the performance condition needed to be wholly within the period of the related service, because they asserted that it was common for a performance target to start before the service period. For example, a performance target could be set as a measure of the growth in earnings per share (the 'EPS target') between the most recently published financial statements on the grant date and the most recently published financial statements before the vesting date.

BC342 Other respondents noted that if the beginning of the period for achieving the performance target was restricted, then a relatively minor difference in the way that the awards are structured could lead to a different classification of the performance target (ie as either a non-vesting condition or a performance (vesting) condition), which could consequently lead to differences in the way in which the award would be accounted for in accordance with the guidance in IFRS 2.

BC343 In response to the comments received on the ED, the Board decided to revise the proposed definition of performance condition. In this revision, the Board decided to ease the restriction on when the period for a performance target could start. It therefore decided to clarify that the start of the period of achieving the performance target could be before the service period, provided that the commencement date of the performance target is not substantially before the commencement of the service period.

BC344 However, the Board decided to retain the proposal in the ED that the period over which the performance target is achieved should not extend beyond the service period. It thought that this decision was consistent with the definition of a performance condition, which was previously included within the definition of a vesting condition. The definition of a performance condition requires the counterparty to complete a specified period of service and to meet the performance target(s) while the counterparty is rendering the service required. The definition of performance condition reflects the principle in paragraph 7 of IFRS 2, which states that "An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received".

BC345 The Board also decided to add the words "ie a **service condition**" to criterion (a) of the definition of performance condition in order to create a cross-reference to the definition of service condition.

## Whether the specified period of service that the counterparty is required to complete can be either implicit or explicit

BC346 In the definition of performance condition, the Board decided to highlight a feature that distinguishes a performance condition from a non-vesting condition in accordance with paragraph BC171A of IFRS 2; namely, that a performance condition has an explicit or implicit service requirement and a non-vesting condition does not. This is so that, in order to constitute a performance condition, a performance target needs to be accompanied by a service requirement, which can be implicit or explicit. The Board observed that if the share-based payment arrangement does not contain an explicit requirement to provide services, the arrangement may still contain an implicit service condition.

## Whether a performance target needs to be influenced by an employee

BC347 During its deliberations the Board observed that for a target to constitute a performance condition it needs to be both 'within the influence' of the employee and in the interest of the entity. Consequently, the Board proposed that the definition of performance condition should make clear that a performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).

BC348 In response to the ED, some respondents indicated that the reason why the performance target needed to be within the influence of the employee was unclear and found it to be contradictory to the proposed definition of performance condition. This is because in the proposed definition, the performance target was defined by reference to the performance of the entity, that is, by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments. Some other respondents also raised some difficulties that they expected to encounter when applying the proposed guidance. In this respect, the respondents stated that determining whether a performance target is within the influence of the employee would be difficult to apply in the case of a group of entities; for example, the profit or share price of a group of companies could be seen to be 'remote from the influence of' an employee of a particular subsidiary of the group.

BC349 The Board observed that requiring a performance target to be within the influence of the employee could be misinterpreted as meaning that the Board's intention was to challenge management to explain how the performance of the employee affects the performance target. The Board confirmed that it was not its intention to do so. It observed that the link between the employee's service/performance against a given performance target is management's responsibility. It noted that each employee has, in varying degrees, an influence over an entity's (or group's) overall performance, that is, over an entity's (or group's) own operations (or activities) or the price (or value) of its equity instruments. Consequently, the Board decided to omit the requirement that the target "needs to be within the influence of the employee" to avoid further confusion.

BC350 In its review of the definition of performance condition the Board also considered what, if any, level of correlation is required between an employee's responsibility and the performance target. Potential diversity in practice had emerged because some were of the view that if share based payment awards are granted to employees conditional on the entity-wide profit, it is not clear that the profit target constitutes a performance condition on the basis that the employee might have so little influence on the entity-wide profit that it is not clear whether the target is able to sufficiently incentivise an individual employee's actions. Others held the view that because the entity is in business in order to make a profit, it is reasonable to assume that all employees contribute directly or indirectly to the entity-wide profit, ie that the whole body of employees contribute towards the entity-wide profit.

BC351 In the ED the Board observed that it is reasonable to assume that the performance target that is set by management for an employee's share-based payment appropriately incentivises the employee to provide an increased quality and/or quantity of service to benefit the entity. Consequently, the Board decided that the definition of performance condition should make clear that a performance target may relate either to the performance of the entity as a whole or to some part of it, such as a division or an individual employee.

BC352 Respondents to the ED questioned whether it was the Board's intention to require an entity to demonstrate, or provide evidence of, the correlation between an employee's responsibility and the performance target in order for that target to be a performance condition. During its deliberations, the Board confirmed that it was not its intention to require an entity to prove this correlation.

## Whether a share market index target may constitute a performance condition or a non-vesting condition

BC353 The Board analysed the case in which a share-based payment is conditional on a share market index target and whether it would be considered a performance condition or a non-vesting condition. For example, a grant might be conditional on a stock exchange index (of which the entity's shares are a part) reaching a specified target and the employee remaining in service up to the date that the target is met.

BC354 The Board observed that some might argue that the share market index target with the implicit service requirement constitutes a performance condition, because an employee is required to provide service to the entity, and that the time estimated to affect the share market index target implicitly determines how long the entity receives the required service. Others might argue that the share market index target is a non-vesting condition because it is not related to the performance of the entity (ie instead it is related to, or based on, not only the entity's share price but also the share price of other unrelated entities).

BC355 In the ED the Board observed that the share market index target would be considered a non-vesting condition because it is not related to the performance of the entity or of another entity in the same group, even if the shares of the entity or of another entity in the same group form part of that index. The Board also observed that a share market index target may be predominantly affected by many external variables or factors involved in its determination, including macroeconomic factors such as the risk-free interest rate or foreign exchange rates and, consequently, it is remote from the influence of the employee.

BC356 Respondents to the ED agreed that it would be reasonable to assume that the share market index target is a non-vesting condition but some thought that it should not be based on the level of influence exercised by an employee over the performance target or on whether the target is affected by external variables or factors. This is because, in their view, the level of influence and the effect of external variables are subjective reasons that are difficult to measure.

BC357 The Board decided to reaffirm its position that a share market index is a non-vesting condition but, on the basis of the comments received, it is clarifying that the reason why it is a non-vesting condition is because a share market index not only reflects the performance of an entity but, in addition, also reflects the performance of other entities outside the group.

BC358 The Board also considered a similar case in which the entity's share price makes up a substantial part of the share market index. The Board determined that even in such a case the condition should still be considered a non-vesting condition because it reflects the performance of other entities that are outside the group.

## Whether the definition of performance condition should indicate that it includes a market condition

BC359 A respondent to the ED noted that the final sentence of the definition of vesting conditions, which states that "a performance condition might include a market condition", is contradictory. This is because a market condition:

(a) is a target that is related to the market price of the entity's equity instruments; and

(b) includes no explicit requirement for the counterparty to complete a specified period of service.

BC360 The Board observed that, on the basis of the definition of performance condition, a performance target that is related to the market price of an entity's equity instruments and to the completion of a specified period of service is considered a market (performance) condition. Consequently, the Board disagreed that an inconsistency existed in the definitions of performance condition and market condition. To avoid confusion in the definitions of performance condition and market condition, the Board decided to:

(a) delete the last sentence in the definition of vesting condition (ie "a performance condition might include a market condition"); and

(b) indicate within the definition of performance condition that performance conditions are either market conditions or non-market conditions.

BC361 The Board decided to confirm that a market condition is a type of performance condition. The Board considered that a condition that is not subject to a service requirement is not a performance condition, and instead, is considered a non-vesting condition. In making this clarification, the Board did not change the measurement requirements in IFRS 2 for a market condition.

## Whether a definition of 'non-vesting condition' is needed

BC362 Respondents to the ED thought that clarity could be further improved in IFRS 2 by defining a 'non-vesting condition'.

BC363 The Board noted that there is no formal definition of non-vesting condition in IFRS 2, but Implementation Guidance on the split between vesting and non-vesting conditions is provided in a flowchart in paragraph IG24 of IFRS 2.

BC364 The Board determined that the creation of a stand-alone definition of non-vesting condition would not be the best alternative for providing clarity on this issue. This is because the Board observed that the concept of a non-vesting condition can be inferred from paragraphs BC170–BC184 of IFRS 2, which clarify the definition of vesting conditions. In accordance with this guidance it can be inferred that a non-vesting condition is any condition that does not determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity under a share-based payment arrangement. In other words, a non-vesting condition is any condition that is not a vesting condition. On the basis of its analysis the Board decided to not add a definition of non-vesting condition.

## Whether the employee's failure to complete a required service period due to termination of employment is considered to be a failure to satisfy a service condition

BC365 When considering a possible revision of the definition of service condition, the Board observed that in IFRS 2 there is no specific guidance on how to account for a share-based payment award when the entity terminates an employee's employment.

BC366 The Board noted, however, that paragraph 19 of this Standard regards the employee's failure to complete a specified service period as a failure to satisfy a service condition. In the ED the Board proposed to clarify within the definition of service condition that if the employee fails to complete a specified service period, the employee thereby fails to satisfy a service condition, regardless of the reason for that failure. The Board also noted that the accounting consequence is that the compensation expense would be reversed if an employee fails to complete a specified service period.

BC367 Some respondents to the ED thought that more clarity could be provided in the proposed guidance. This is because they noted that in some circumstances in which an employee is unable to perform the service condition by completing the stipulated service period (such as when the employee is ill or dies in service), it would normally be expected that part of the award would vest and that the related compensation expense should not be reversed. They noted that, to the extent that a portion of the award vests, that portion should be recognised as an expense.

BC368 In response to the comments received, the Board noted that the objective of the proposed amendment to the definition of service condition is to clarify that the termination of an employee's employment is a situation in which the employee fails to complete a specified service period and, consequently, is considered a situation in which the service condition is not met.

BC369 The Board observed that in circumstances in which equity instruments do not vest because of failure to satisfy a vesting condition, paragraph 19 of IFRS 2 states that "on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of a failure to satisfy a vesting condition". The Board observed that in circumstances in which the equity instruments either partly or fully vest on cessation of employment, paragraph 23 of IFRS 2 states that "the entity shall make no subsequent adjustment to total equity after vesting date". The Board also noted that, in accordance with paragraph 28, "if a grant of equity instruments is cancelled or settled during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied) the entity shall account for the cancellation or settlement as an acceleration of vesting, and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period". Noting the guidance already provided in IFRS 2, the Board concluded that further guidance was not necessary.

## Transition provisions

BC370 The Board considered the transition provisions and effective date of the amendment to IFRS 2. The Board noted that the changes to the definitions of vesting conditions and market condition and the addition of performance condition and service condition might result in changes to the grant-date fair value of share-based payment transactions for which the grant date was in previous periods. To avoid the use of hindsight, it decided that an entity would apply the amendments to IFRS 2 prospectively to share-based payment transactions for which the grant date is on or after 1 July 2014. Earlier application should be permitted.

*Guidance on Implementing*
*Hong Kong Financial Reporting Standard 2*

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# Appendix A

## Amendments to the Guidance on implementing IFRS 2 *Classification and Measurement of Share-based Payment Transactions*

*The following sets out amendments required for this Guidance resulting from amendments to IFRS 2 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted.*

Paragraph IG19 is amended and paragraphs IG19A–IG19B are added. IG Examples 12A–12C are added. Deleted text is struck through and new text is underlined.

## Cash-settled share-based payment transactions

...

IG19 For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity recognises the services received, and a liability to pay for them, as the employees render service during that period. The liability is measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights~~, by applying an option pricing model, and the extent to which the employees have rendered service to date~~ in accordance with paragraphs 30–33D of IFRS 2. Changes in fair value are recognised in profit or loss. Therefore, if the amount recognised for the services received was included in the carrying amount of an asset recognised in the entity's statement of financial position (~~eg~~for example, inventory), the carrying amount of that asset is not adjusted for the effects of the liability remeasurement. Example 12 illustrates these requirements for a cash-settled share-based payment transaction that is subject to a service condition. Example 12A illustrates these requirements for a cash-settled share-based payment transaction that is subject to a performance condition.

**IG Example 12**

…

**IG Example 12A**

**Background**

An entity grants 100 cash-settled share appreciation rights (SARs) to each of its 500 employees on the condition that the employees remain in its employ for the next three years and the entity reaches a revenue target (CU1 billion in sales) by the end of Year 3. The entity expects all employees to remain in its employ.

***continued…***

***…continued***
**IG Example 12A**

For simplicity, this example assumes that none of the employees' compensation qualifies for capitalisation as part of the cost of an asset.

At the end of Year 1, the entity expects that the revenue target will not be achieved by the end of Year 3. During Year 2, the entity's revenue increased significantly and it expects that it will continue to grow. Consequently, at the end of Year 2, the entity expects that the revenue target will be achieved by the end of Year 3.

At the end of Year 3, the revenue target is achieved and 150 employees exercise their SARs. Another 150 employees exercise their SARs at the end of Year 4 and the remaining 200 employees exercise their SARs at the end of Year 5.

Using an option pricing model, the entity estimates the fair value of the SARs, ignoring the revenue target performance condition and the employment-service condition, at the end of each year until all of the cash-settled share-based payments are settled. At the end of Year 3, all of the SARs vest. The following table shows the estimated fair value of the SARs at the end of each year and the intrinsic values of the SARs at the date of exercise (which equals the cash paid out).

| Year | Fair value of one SAR | Intrinsic value of one SAR |
|---|---|---|
| 1 | CU14.40 | – |
| 2 | CU15.50 | – |
| 3 | CU18.20 | CU15.00 |
| 4 | CU21.40 | CU20.00 |
| 5 | CU25.00 | CU25.00 |

| **Application of requirements** | Number of employees expected to satisfy the service condition | Best estimate of whether the revenue target will be met |
|---|---|---|
| Year 1 | 500 | No |
| Year 2 | 500 | Yes |
| Year 3 | 500 | Yes |

| Year | Calculation | Expense | Liability |
|---|---|---|---|
| | | CU | CU |
| 1 | SARs are not expected to vest: no expense is recognised | – | – |
| 2 | SARs are expected to vest: 500 employees × 100 SARs × CU15.50 × 2⁄3 | 516,667 | 516,667 |

***continued…***

***…continued***
**IG Example 12A**

| | | | | |
|---|---|---|---|---|
| 3 | (500–150) employees × 100 SARs × CU18.20 x 3⁄3–CU516,667 | 120,333 | | 637,000 |
| | + 150 employees × 100 SARs × CU15.00 | 225,000 | | |
| | Total | | 345,333 | |
| 4 | (350–150) employees × 100 SARs × CU21.40–CU637,000 | (209,000) | | 428,000 |
| | + 150 employees × 100 SARs × CU20.00 | 300,000 | | |
| | Total | | 91,000 | |
| 5 | (200–200) employees × 100 SARs × CU25.00–CU428,000 | (428,000) | | – |
| | + 200 employees × 100 SARs × CU25.00 | 500,000 | | |
| | Total | | 72,000 | |
| | Total | | 1,025,000 | |

## Share-based payment transactions with a net settlement feature for withholding tax obligations

IG19A Paragraphs 33E and 33F require an entity to classify an arrangement in its entirety as an equity-settled share-based payment transaction if it would have been so classified in the absence of a net settlement feature that obliges the entity to withhold an amount for an employee's tax obligation associated with a share-based payment. The entity transfers that amount, normally in cash, to the tax authority on the employee's behalf. Example 12B illustrates these requirements.

**IG Example 12B**

**Background**

The tax law in jurisdiction X requires entities to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount in cash to the tax authority on the employee's behalf.

On 1 January 20X1 an entity in jurisdiction X grants an award of 100 shares to an employee; that award is conditional upon the completion of four years' service. The entity expects that the employee will complete the service period. For simplicity, this example assumes that none of the employee's compensation qualifies for capitalisation as part of the cost of an asset.

***continued…***

***…continued***
**IG Example 12B**

The terms and conditions of the share-based payment arrangement require the entity to withhold shares from the settlement of the award to its employee in order to settle the employee's tax obligation (that is, the share-based payment arrangement has a 'net settlement feature'). Accordingly, the entity settles the transaction on a net basis by withholding the number of shares with a fair value equal to the monetary value of the employee's tax obligation and issuing the remaining shares to the employee on completion of the vesting period.

The employee's tax obligation associated with the award is calculated based on the fair value of the shares on the vesting date. The employee's applicable tax rate is 40 per cent.

At grant date, the fair value of each share is CU2. The fair value of each share at 31 December 20X4 is CU10.

The fair value of the shares on the vesting date is CU1,000 (100 shares × CU10 per share) and therefore the employee's tax obligation is CU400 (100 shares × CU10 × 40%). Accordingly, on the vesting date, the entity issues 60 shares to the employee and withholds 40 shares (CU400 =40 shares × CU10 per share). The entity pays the fair value of the withheld shares in cash to the tax authority on the employee's behalf. In other words, it is as if the entity had issued all 100 vested shares to the employee, and at the same time, repurchased 40 shares at their fair value.

**Application of requirements**

| Year | Calculation | Dr. Expense CU | Cr. Equity CU | Cr. Liability CU |
|---|---|---|---|---|
| 1 | 100 shares × CU2 × 1⁄4 | 50 | (50) | – |
| 2 | 100 shares × CU2 × 2⁄4 –CU50 | 50 | (50) | – |
| 3 | 100 shares × CU2 × 3⁄4 –(CU50 + CU50) | 50 | (50) | – |
| 4 | 100 shares × CU2 × 4⁄4 –(CU50 + CU50 + CU50) | 50 | (50) | – |
| | Total | 200 | (200) | – |

**The journal entries recorded by the entity are as follows:**

*During the vesting period*

Accumulated compensation expense recognised over the vesting period

| | | |
|---|---|---|
| Dr Expense | 200 | |
| | Cr Equity | 200 |

*Recognition of the tax liability*[a]

| | | |
|---|---|---|
| Dr Equity | 400 | |
| | Cr Liability | 400 |

***continued…***

***…continued***
**IG Example 12C**

(b) the liability for the SARs is derecognised at the modification date; and

(c) the difference between the carrying amount of the liability derecognised and the equity amount recognised at the modification date is recognised immediately in profit or loss.

At the modification date (31 December 20X2), the entity compares the fair value of the equity-settled replacement award for services provided through to the modification date (CU132,000 × 2⁄4 = CU66,000) with the fair value of the cash-settled original award for those services (CU120,000 × 2⁄4 = CU60,000). The difference (CU6,000) is recognised immediately in profit or loss at the date of the modification.

The remainder of the equity-settled share-based payment (measured at its modification-date fair value) is recognised in profit or loss over the remaining two-year vesting period from the date of the modification.

| Year | Calculation | Dr. Expense | Cumulative expense | Cr. Equity | Cr. Liability |
|---|---|---|---|---|---|
| | | CU | CU | CU | CU |
| 1 | 100 employees ×100 SARs x CU10 × 1⁄4 | 25,000 | – | – | 25,000 |
| 2 | *Remeasurement before the modification* 100 employees x 100 SARs × CU12.00 × 2⁄4–25,000 | 35,000 | 60,000 | – | 35,000 |
| | *Derecognition of the liability, recognition of the modification-date fair value amount in equity and recognition of the effect of settlement for CU6,000* (100 employees x 100 share options × CU13.20 × 2⁄4)–(100 employees × 100 SARs × CU12.00 × 2⁄4) | 6,000 | 66,000 | 66,000 | (60,000) |
| 3 | 100 employees × 100 share options × CU13.20 × 3⁄4–CU66,000 | 33,000 | 99,000 | 33,000 | – |
| 4 | 100 employees x 100 share options × CU13.20 × 4⁄4–CU99,000 | 33,000 | 132,000 | 33,000 | – |
| | Total | | | 132,000 | – |

HKFRS 3 (Revised)
Revised November ~~2014~~ 2016

Effective for annual periods
beginning on or after 1 July 2009

*Hong Kong Financial Reporting Standard 3 (Revised)*

# Business Combinations

Hong Kong Institute of
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| | |
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# Hong Kong Financial Reporting Standard 3
# *Business Combinations*

## Objective

1 The objective of this HKFRS is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a *business combination* and its effects. To accomplish that, this HKFRS establishes principles and requirements for how the *acquirer*:

(a) recognises and measures in its financial statements the *identifiable* assets acquired, the liabilities assumed and any *non-controlling interest* in the *acquiree*;

(b) recognises and measures the *goodwill* acquired in the business combination or a gain from a bargain purchase; and

(c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

## Scope

2 This HKFRS applies to a transaction or other event that meets the definition of a business combination. This HKFRS does not apply to:

(a) the accounting for the formation of a ~~joint venture~~joint arrangement in the financial statements of the joint arrangement itself.

(b) the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in HKAS 38 *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill.

(c) a combination of entities or businesses under common control (paragraphs B1–B4 provide related application guidance).

2A The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in HKFRS 10 *Consolidated Financial Statements*, of an investment in a subsidiary that is required to be measured at fair value through profit or loss.

## Identifying a business combination

**3 An entity shall determine whether a transaction or other event is a business combination by applying the definition in this HKFRS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12 provide guidance on identifying a business combination and the definition of a business.**

## The acquisition method

**4 An entity shall account for each business combination by applying the acquisition method.**

5 Applying the acquisition method requires:

(a) identifying the acquirer;

(b) determining the *acquisition date*;

(c) recognising and measuring the identifiable assets acquired, the liabilities assumed

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

**Consideration transferred**

37 The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. (However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with paragraph 30 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, *contingent consideration*, ordinary or preference equity instruments, options, warrants and member interests of *mutual entities*.

38 The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in profit or loss. However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

*Contingent consideration*

39 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 37). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

40 The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of HKAS 32 *Financial Instruments: Presentation*~~, or other applicable HKFRSs~~. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 provides guidance on the subsequent accounting for contingent consideration.

## Additional guidance for applying the acquisition method to particular types of business combinations

**A business combination achieved in stages**

41 An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This HKFRS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition.

### Contingent liabilities

56 After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

(a) the amount that would be recognised in accordance with HKAS 37; and

(b) the amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

This requirement does not apply to contracts accounted for in accordance with HKAS 39.

### Indemnification assets

57 At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset. The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

### Contingent consideration

58 Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 45-49. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.

(b) Other c~~C~~ontingent consideration ~~classified as an asset or a liability~~ that:

(i) ~~is a financial instrument and~~ is within the scope of HKFRS 9 shall be measured at fair value at each reporting date, ~~with any resulting gain or loss recognised either in profit or loss or in other comprehensive income~~ and changes in fair value shall be recognised in profit or loss in accordance with HKFRS 9.

(ii) is not within the scope of HKFRS 9 shall be ~~accounted for in accordance with HKAS 37 or other HKFRSs as appropriate.~~ measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss.

## Disclosures

**59 The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:**

**(a) during the current reporting period; or**

**(b) after the end of the reporting period but before the financial statements are authorised for issue.**

60 To meet the objective in paragraph 59, the acquirer shall disclose the information specified in paragraphs B64-B66.

**61 The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.**

62 To meet the objective in paragraph 61, the acquirer shall disclose the information specified in paragraph B67.

63 If the specific disclosures required by this and other HKFRSs do not meet the objectives set out in paragraphs 59 and 61, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

## Effective date and transition

### Effective date

64 This HKFRS shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted. However, this HKFRS shall be applied only at the beginning of an annual reporting period that begins on or after 30 June 2007. If an entity applies this HKFRS before 1 July 2009, it shall disclose that fact and apply HKAS 27 (as amended in 2008) at the same time.

*64A [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]*

64B *Improvements to HKFRSs* issued in May 2010 amended paragraphs 19, 30 and B56 and added paragraphs B62A and B62B. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. Application should be prospective from the date when the entity first applied this HKFRS.

64C Paragraphs 65A–65E were added by *Improvements to HKFRSs* issued in May 2010. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. The amendments shall be applied to contingent consideration balances arising from business combinations with an acquisition date prior to the application of this HKFRS, as issued in 2008.

*64D [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]*

64E HKFRS 10, issued in June 2011, amended paragraphs 7, B13, B63(e) and Appendix A. An entity shall apply those amendments when it applies HKFRS 10.

64F HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended paragraphs 20, 29, 33, 47, amended the definition of fair value in Appendix A and amended paragraphs B22, B40, B43–B46, B49 and B64. An entity shall apply those amendments when it applies HKFRS 13.

64G *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraph 7 and added paragraph 2A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies these amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

64H [Deleted]

64I *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraphs 40 and 58 and added paragraph 67A and its related heading. An entity shall apply that amendment prospectively to business combinations for which the acquisition date is on or after 1 July 2014. Earlier application is permitted. An entity may apply the amendment earlier provided that HKFRS 9 and HKAS 37 (both as amended by *Annual Improvements to HKFRSs 2010–2012 Cycle*) have also been applied. If an entity applies that amendment earlier it shall disclose that fact.

64J *Annual Improvements Cycle 2011–2013* issued in January 2014 amended paragraph 2(a). An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

## Transition

65 Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this HKFRS shall not be adjusted upon application of this HKFRS.

65A Contingent consideration balances arising from business combinations whose acquisition dates preceded the date when an entity first applied this HKFRS as issued in 2008 shall not be adjusted upon first application of this HKFRS. Paragraphs 65B–65E shall be applied in the subsequent accounting for those balances. Paragraphs 65B–65E shall not apply to the accounting for contingent consideration balances arising from business combinations with acquisition dates on or after the date when the entity first applied this HKFRS as issued in 2008. In paragraphs 65B–65E business combination refers exclusively to business combinations whose acquisition date preceded the application of this HKFRS as issued in 2008.

65B If a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably.

65C A business combination agreement may allow for adjustments to the cost of the combination that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the time of initially accounting for the combination without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.

65D However, when a business combination agreement provides for such an adjustment, that adjustment is not included in the cost of the combination at the time of initially accounting for the combination if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

65E In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the business combination and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the business combination is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

66 An entity, such as a mutual entity, that has not yet applied HKFRS 3 and had one or more business combinations that were accounted for using the purchase method shall apply the transition provisions in paragraphs B68 and B69.

**Income taxes**

67 For business combinations in which the acquisition date was before this HKFRS is applied, the acquirer shall apply the requirements of paragraph 68 of HKAS 12, as amended by this HKFRS, prospectively. That is to say, the acquirer shall not adjust the accounting for prior business combinations for previously recognised changes in recognised deferred tax assets. However, from the date when this HKFRS is applied, the acquirer shall recognise, as an adjustment to profit or loss (or, if HKAS 12 requires, outside profit or loss), changes in recognised deferred tax assets.

## Reference to HKFRS 9

67A If an entity applies this Standard but does not yet apply HKFRS 9, any reference to HKFRS 9 should be read as a reference to HKAS 39.

## Withdrawal of HKFRS 3 (issued 2004)

68 This HKFRS supersedes HKFRS 3 *Business Combinations* issued in 2004 as amended in 2005 and 2007.

HKFRS 3 (Revised) BC
Revised November ~~2014~~ 2016

*Basis for Conclusions on*
*Hong Kong Financial Reporting Standard 3 (Revised)*

# Business Combinations

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| | |
|---|---|
| **Disclosure requirements of IFRS 3** | **BC411** |
| **Disclosure requirements of the revised standards** | **BC419** |
| **Disclosure of information about post-combination revenue and profit or loss of the acquiree** | **BC423** |
| **EFFECTIVE DATE AND TRANSITION** | **BC429** |
| **Effective date and transition for combinations of mutual entities or by contract alone** | **BC433** |
| **Transition requirements for contingent consideration from a business combination that occurred before the effective date of IFRS 3 (as revised in 2008)** | **BC434A** |
| **Effective date and transition for clarifications of the accounting for contingent consideration that arises from business combinations** | **BC434D** |
| **BENEFITS AND COSTS** | **BC435** |
| **DISSENTING OPINIONS ON IFRS 3** | |

**APPENDICES**

**A Amendments to the Basis for Conclusions on other IFRSs**

cannot be identified or as one in which the acquirer is substantially modified by the transaction. However, the boards observed that those transactions have been accounted for by the acquisition method and they decided not to change that practice.

BC57 Neither the IASB nor the FASB has on its agenda a project to consider the fresh start method. However, both boards have expressed interest in considering whether joint venture formations and some formations of new entities in multi-party business combinations should be accounted for by the fresh start method. Depending on the relative priorities of that topic and other topics competing for their agendas when time becomes available, the boards might undertake a joint project to consider those issues at some future date.

## Scope

BC58 The revised standards exclude from their scope some transactions that were also excluded from the scope of both IFRS 3 and SFAS 141. However, the revised standards include within their scope combinations involving only mutual entities and combinations achieved by contract alone, which were excluded from the scope of IFRS 3 and SFAS 141. Paragraphs BC59–BC79 discuss the boards' reasons for those conclusions.

### Joint ventures and combinations of entities under common control

BC59 Formations of joint ventures and combinations of entities under common control are excluded from the scope of the revised standards. Those transactions were also excluded from the scope of both IFRS 3 and SFAS 141, and the boards continue to believe that issues related to such combinations are appropriately excluded from the scope of this project. The boards are aware of nothing that has happened since IFRS 3 and SFAS 141 were issued to suggest that the revised standards should be delayed to address the accounting for those events.

BC60 In developing IFRS 3, the IASB considered whether it should amend the definition of joint control in IAS 31 *Interests in Joint Ventures*[*] because it was concerned that its decision to eliminate the pooling method would create incentives for business combinations to be structured to meet the definition of a joint venture. After considering comments on the definition proposed in ED 3, the IASB revised the definition of joint control in IAS 31 to clarify that:

(a) unanimous consent on **all** financial and operating decisions is not necessary for an arrangement to satisfy the definition of a joint venture-unanimous consent on only strategic decisions is sufficient.

(b) in the absence of a contractual agreement requiring unanimous consent to strategic financial and operating decisions, a transaction in which the owners of multiple businesses agree to combine their businesses into a new entity (sometimes referred to as a roll-up transaction) should be accounted for by the acquisition method. Majority consent on such decisions is not sufficient.

BC61 In developing SFAS 141, the FASB noted that constituents consider the guidance in paragraph 3(d) of APB Opinion No. 18 *The Equity Method of Accounting for Investments in Common Stock* in assessing whether an entity is a joint venture, and it decided not to change that practice in its project on business combinations.

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

*Annual Improvements Cycle 2011–2013*

BC61A The IASB observed that there was uncertainty about whether paragraph 2(a) of IFRS 3, which excludes the formation of joint ventures from the scope of IFRS 3, should have been amended to refer to joint arrangements when IFRS 11 was issued. IFRS 11 had changed the use of the term 'joint venture' from having a general meaning that included 'jointly controlled operations', 'jointly controlled assets' and 'jointly controlled entities', to meaning a specific type of joint arrangement, which does not include 'joint operations'. The IASB did not change the wording of the scope exclusion in paragraph 2(a) of IFRS 3 for 'the formation of a joint venture' when it replaced IAS 31 with IFRS 11 *Joint Arrangements*, although it had not intended to change the scope of IFRS 3.

BC61B There was also uncertainty about whether the scope exclusion in paragraph 2(a) of IFRS 3 addresses:

(a) the accounting by the joint arrangements themselves in their financial statements only; or also

(b) the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

BC61C The IASB noted that paragraph 2(a) of IFRS 3 should exclude formations of every type of joint arrangement (ie joint ventures and joint operations) from the scope of IFRS 3. It also noted that paragraph 2(a) of IFRS 3 excludes, from the scope of IFRS 3, only the accounting by the joint arrangements themselves in their financial statements.

BC61D The IASB concluded that paragraph 2(a) of IFRS 3 should be amended to address all types of joint arrangements and to remove uncertainty about the financial statements to which it applies.

BC61E Consequently, the IASB amended paragraph 2(a) of IFRS 3 to:

(a) exclude the formation of all types of joint arrangements from the scope of IFRS 3 by replacing 'joint venture' with 'joint arrangement'; and

(b) clarify that the only scope exclusion needed from the scope of IFRS 3 is the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.

## Not-for-profit organisations

BC62 The FASB also decided to exclude from the scope of SFAS 141(R) business combinations of not-for-profit organisations and acquisitions of for-profit businesses by not-for-profit organisations. Some aspects of combinations of not-for-profit organisations are different from combinations of business entities. For example, it cannot be presumed that combinations of organisations that serve a public interest are necessarily exchange transactions in which willing parties exchange equal values. For that reason, the FASB is

BC357 Except for adjustments during the measurement period to provisional estimates of fair values at the acquisition date, the boards concluded that subsequent changes in the fair value of a liability for contingent consideration do not affect the acquisition-date fair value of the consideration transferred. Rather, those subsequent changes in value are generally directly related to post-combination events and changes in circumstances related to the combined entity. Thus, subsequent changes in value for post-combination events and circumstances should not affect the measurement of the consideration transferred or goodwill on the acquisition date. (The boards acknowledge that some changes in fair value might result from events and circumstances related in part to a pre-combination period. But that part of the change is usually indistinguishable from the part related to the post-combination period and the boards concluded that the benefits in those limited circumstances that might result from making such fine distinctions would not justify the costs that such a requirement would impose.)

BC358 The boards also considered arguments that the results of the requirements of the revised standards for recognition of changes in the fair value of contingent consideration after the acquisition date are counter-intuitive because they will result in:

(a) recognising gains if the specified milestone or event requiring the contingent payment is not met. For example, the acquirer would recognise a gain on the reversal of the liability if an earnings target in an earn-out arrangement is not achieved.

(b) recognising losses if the combined entity is successful and the amount paid exceeds the estimated fair value of the liability at the acquisition date.

BC359 The boards accept the consequence that recognising the fair value of a liability for payment of contingent consideration is likely to result subsequently in a gain if smaller or no payments are required or result in a loss if greater payments are required. That is a consequence of entering into contingent consideration arrangements related to future changes in the value of a specified asset or liability or earnings of the acquiree after the acquisition date. For example, if a contingent consideration arrangement relates to the level of future earnings of the combined entity, higher earnings in the specified periods may be partially offset by increases in the liability to make contingent payments based on earnings because the acquirer has agreed to share those increases with former owners of the acquiree.

BC360 The boards also observed that liabilities for contingent payments may be related to contingencies surrounding an outcome for a particular asset or another liability. In those cases, the effect on income of the period of a change in the fair value of the liability for the contingent payment may be offset by a change in the value of the asset or other liability. For example, after an acquisition the combined entity might reach a favourable settlement of pending litigation of the acquiree for which it had a contingent consideration arrangement. If the combined entity is thus required to make a contingent payment to the seller of the acquiree that exceeds the initially estimated fair value of the liability for contingent consideration, the effect of the increase in that liability may be offset in part by the reduction in the liability to the litigation claimant. Similarly, if the acquirer is not required to make a contingent payment to the seller because an acquired research and development project failed to result in a viable product, the gain from the elimination of the liability may be offset, in whole or in part, by an impairment charge to the asset acquired.

*Clarification on the accounting for contingent consideration in a business combination*

BC360A The IASB clarified the accounting for contingent consideration arising from business combinations.

**Classification of contingent consideration in a business combination**

BC360B The IASB noted that the classification requirements in paragraph 40 of IFRS 3 were unclear as to when, if ever, “other applicable IFRSs” would need to be used to determine the classification of contingent consideration as a financial liability or as an equity instrument. Consequently, the IASB deleted the reference to “other applicable IFRSs” in paragraph 40.

**Subsequent measurement of contingent consideration in a business combination**

BC360C The IASB also noted that the requirements for subsequent measurement in paragraph 58 require contingent consideration, other than that which meets the definition of equity in accordance with IAS 32 *Financial Instruments: Presentation*, to be subsequently measured at fair value. However, paragraph 58 then refers to IFRS 9 *Financial Instruments* (or IAS 39, if IFRS 9 has not yet been applied), IAS 37 or other IFRSs as appropriate, which may not require subsequent measurement at fair value.

**Subsequent measurement of contingent consideration that is a financial instrument**

BC360D The IASB noted that the requirements for subsequent measurement in paragraph 58 for contingent consideration that is a financial instrument within the scope of IFRS 9 (or IAS 39) were inconsistent with the accounting requirements of IFRS 9 (or IAS 39). Because paragraph 58 referred to IFRS 9 (or IAS 39), which allows amortised cost measurement in some circumstances, contingent consideration that is a financial liability might be classified as being measured at amortised cost. This would conflict with the requirement in paragraph 58 that such contingent consideration should be subsequently measured at fair value. Consequently, the IASB amended the classification requirements of IFRS 9 (and IAS 39) to ensure that the subsequent measurement requirement for contingent consideration that is a financial liability is fair value. The IASB thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

BC360E In redeliberating this issue, the IASB decided that it would not be possible for contingent consideration that is a financial asset that meets the requirements in IFRS 9 to be subsequently measured at amortised cost (because the contractual terms of contingent consideration that is a financial asset would not give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding). Consequently, the IASB decided that the proposed amendments to paragraph 4.1.2 of IFRS 9 in the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle* were not needed.

BC360F The IASB also decided that changes in fair value of any contingent consideration that is a financial asset or a financial liability should be recognised in profit or loss. Consequently, the IASB decided to amend paragraph 5.7.5 of IFRS 9 to ensure that any change in the fair value of investments in equity instruments that are contingent consideration in a business combination should be presented in profit or loss. The IASB noted that it was unlikely that contingent consideration that is an asset would meet the definition of equity. However, it decided to amend the paragraph to ensure that all contingent consideration that is made up of financial instruments is accounted for consistently.

**Subsequent measurement of contingent consideration that is a non-financial asset or a non-financial liability**

BC360G The IASB also noted that the subsequent measurement requirements in paragraph 58(b) for contingent consideration that is a non-financial asset or a non-financial liability may conflict with the measurement requirements in other applicable Standards. The conflict arises because paragraph 58 refers to changes in the fair value of contingent consideration but paragraph 58(b) refers to Standards that do not require fair value as a measurement basis, for example, IAS 37. Consequently, the IASB deleted the reference to "IAS 37 or other IFRSs as appropriate" from paragraph 58(b). This, therefore, maintains fair value as the subsequent measurement basis for all non equity contingent consideration to which IFRS 3 applies. The IASB thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

BC360H The IASB also decided that the full change in the fair value of any contingent consideration that is a non-financial asset or a non-financial liability should be recognised in profit or loss.

**Other considerations given to subsequent measurement of contingent consideration**

BC360I The IASB considered alternatives for the subsequent measurement requirements for contingent consideration. It considered whether all references to other Standards, including references to IFRS 9 (or IAS 39), should be removed and instead all necessary guidance for the subsequent measurement of contingent consideration should be included in IFRS 3. It decided, however, to amend IFRS 9 (and IAS 39) as a consequential amendment derived from the amendment to IFRS 3 and to retain the link to IFRS 9 (or IAS 39) so that the general guidance in IFRS 9 (or IAS 39) applies to contingent consideration that is within the scope of IFRS 9 (or IAS 39). The IASB also considered whether some liability contingent consideration should be measured at fair value with some fair value changes being presented in other comprehensive income. It decided that it was preferable that the guidance was consistent for all liability contingent consideration and, consequently, it decided that all liability contingent consideration should be subsequently measured at fair value with any resulting gain or loss, including gain or loss attributable to changes in own credit risk, being recognised in profit or loss.

**Disclosure**

BC360J Some stakeholders had asked whether the IASB had intended the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* to apply to contingent consideration, noting that there are disclosure requirements for contingent consideration in IFRS 3. The IASB thinks that it is appropriate for the disclosure requirements of IFRS 7 to apply to contingent consideration that is a financial instrument within the scope of IFRS 7. Consequently, the IASB decided not to make any changes to the scope of IFRS 7 to exclude such financial instruments.

*Replacement awards*

BC361 An acquirer sometimes issues replacement awards to benefit the employees of the acquiree for past services, for future services or for both. Accordingly, the 2005 Exposure Draft included guidance for determining the extent to which replacement awards are for past services (and thus part of the consideration transferred in the business combination) or future services (and thus not part of the consideration transferred). In developing that guidance, the boards' objective was, as far as possible, to be consistent with the guidance in their respective standards on share-based payments.

## Effective date and transition for combinations of mutual entities or by contract alone

BC433 IFRS 3 excluded from its scope combinations of mutual entities and those achieved by contract alone. In developing IFRS 3, the IASB decided that these combinations should be excluded from its scope until the IASB published interpretative guidance for the application of the acquisition method to those transactions. The revised IFRS 3 provides that guidance. The effective date for combinations of mutual entities and those achieved by contract alone is the same as the effective date for all other entities applying the revised IFRS 3.

BC434 For the reasons outlined in paragraph BC180 of IFRS 3 the IASB concluded that the transitional provisions for combinations involving mutual entities only or those achieved by contract alone should be prospective. Given that these combinations were not within the scope of IFRS 3, they may have been accounted for differently from what IFRS 3 required. The transitional provisions in IFRS 3 took into consideration that entities may have used a range of alternatives in accounting for combinations in the past. The IASB concluded that the transitional provisions for these combinations should incorporate the transitional provisions in IFRS 3 for other business combinations. In addition, the IASB concluded that the transitional provisions should provide that an entity should continue to classify prior combinations in accordance with its previous accounting for such combinations. This is consistent with the prospective approach. Those provisions are contained in paragraphs B68 and B69 of the revised IFRS 3.

## Transition requirements for contingent consideration from a business combination that occurred before the effective date of IFRS 3 (as revised in 2008)

BC434A In *Improvements to IFRSs* issued in May 2010, the Board addressed a perceived conflict in the guidance on accounting for contingent consideration in a business combination. The perceived conflict related to the transition guidance for contingent consideration arising from business combinations that had been accounted for in accordance with IFRS 3 (as issued in 2004). Before their deletion in January 2008, paragraph 3(c) of IFRS 7 ~~*Financial Instruments: Disclosures*~~, paragraph 4(c) of IAS 32 ~~*Financial Instruments: Presentation*~~ and paragraph 2(f) of IAS 39 ~~*Financial Instruments: Recognition and Measurement*~~ excluded contingent consideration arrangements from the scope of those IFRSs. To allow the acquirer to account for contingent consideration as required by IFRS 3 (revised 2008), the Board deleted those scope exceptions in the second phase of its project on business combinations.

BC434B Some interpreted the deletion of the scope exception as meaning that IAS 39 would apply to all contingent consideration, including contingent consideration from business combinations with an acquisition date earlier than the application date of IFRS 3 (revised 2008). However, this interpretation is inconsistent with the transition guidance in paragraph 65 of IFRS 3 (revised 2008).

BC434C Therefore, the Board reproduced paragraphs 32–35 of IFRS 3 (as issued in 2004) as paragraphs 65B–65E in IFRS 3 (revised 2008) and made the conforming changes to IFRS 7, IAS 32 and IAS 39. The Board did this to clarify that the requirements in IAS 39 do not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (revised 2008) and to provide guidance on how to account for such balances. The Board believes that the amendments will not cause IFRS 3 to diverge from FASB ASC Topic 805 *Business Combinations* (SFAS 141(R) *Business Combinations*).

### Effective date and transition for clarifications of the accounting for contingent consideration that arises from business combinations

BC434D *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, clarifies the accounting for contingent consideration that arises from business combinations. The IASB considered whether the transition provisions of paragraph 19 in IAS 8 should apply, which require retrospective application. The IASB considered that the amendments required fair value measurement, and that some entities might not have previously applied fair value measurement for the subsequent measurement of contingent consideration. Retrospective application might therefore require the determination of fair value for contingent consideration, which might not have been previously measured at fair value following initial recognition. It may be impracticable for an entity to determine the fair value of such contingent consideration without using hindsight. Consequently, the IASB decided to require prospective application to avoid the risk of hindsight being applied. The IASB also decided on a 1 July 2014 mandatory effective date for the amendments to IFRS 3 and the consequential amendments to IAS 37 as well as to IFRS 9 and IAS 39, depending on the financial instruments Standard that is applied by the entity at the time that this amendment becomes effective.

### Scope exceptions for joint ventures

BC434E *Annual Improvements Cycle 2011–2013* issued in December 2013 amended paragraph 2(a) and added paragraph 64I to clarify the scope exception in paragraph 2(a) of IFRS 3. It took into consideration the transition provisions and effective date of the amendment to IFRS 3. In order to be consistent with the prospective initial application of IFRS 3, the IASB decided that an entity shall apply the amendment to IFRS 3 prospectively for annual periods beginning on or after 1 July 2014.

## Benefits and costs

BC435 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. However, the benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs do not necessarily fall on those who enjoy the benefits. For these reasons, it is difficult to apply a cost-benefit test in any particular case. In making its judgement, the IASB considers:

(a) the costs incurred by preparers of financial statements;

(b) the costs incurred by users of financial statements when information is not available;

(c) the comparative advantage that preparers have in developing information, when compared with the costs that users would incur to develop surrogate information; and

(d) the benefit of better economic decision-making as a result of improved financial reporting.

In the second phase of the business combinations project the IASB also considered the costs and benefits of the revised IFRS 3 relative to IFRS 3.

BC436 The IASB concluded that the revised IFRS 3 benefits both preparers and users of financial statements by converging to common high quality, understandable and enforceable accounting standards for business combinations in IFRSs and US GAAP. This improves the comparability of financial information around the world and it also simplifies and reduces the costs of accounting for entities that issue financial statements in accordance with both IFRSs and US GAAP.

BC437 The revised IFRS 3 builds on the core principles established by IFRS 3. However, the IASB sought to improve the understandability, relevance, reliability and comparability of information provided to users of financial statements as follows:

(a) **Scope**

The revised IFRS 3 has a broader scope than IFRS 3. Those entities that will now be required to apply the acquisition method might incur additional costs to obtain valuations and account for intangible assets and goodwill after the acquisition date. However, the IASB observes that much of the information required to account for a business combination by applying the acquisition method is already prepared by those entities that are currently applying the pooling of interests method. There might be additional costs associated with presenting this information within the financial statements, such as audit costs, but much of the information will already be available to management. The IASB concluded therefore that the benefits of improved comparability and faithful representation outweigh the costs that those entities will incur.

(b) **Non-controlling interest**

Paragraph 19 of the revised IFRS 3 provides preparers of financial statements with a choice for each business combination to measure initially a non-controlling interest either at fair value or as the non-controlling interest's proportionate share of the acquiree's identifiable net assets. Paragraphs BC209–BC221 discuss the benefits and costs associated with granting a choice on how non-controlling interests should be measured.

(c) **Contingent consideration**

Paragraph 58 of the revised IFRS 3 requires contingent consideration that is classified as a liability and is within the scope of IAS 39 to be remeasured to fair value (or for those within the scope of IAS 37 or another IFRS, to be accounted for in accordance with that IFRS)[*] and that contingent consideration classified as equity is not remeasured. The IASB understands that remeasuring the fair value of contingent consideration after the acquisition date results in additional costs to preparers. Preparers will need to measure the fair value of these arrangements or will need to obtain external valuations at the end of each reporting period. However, users have stated that the information they receive under IFRS 3 is too late to be useful. The IASB concluded therefore that the benefits of relevance and representational faithfulness and the increased information that would be provided to users outweigh the costs.

(d) **Acquisition-related costs**

Paragraph 53 of the revised IFRS 3 requires the costs the acquirer incurs in connection with a business combination to be accounted for separately from the business combination. The IASB concluded that this treatment would improve the understandability of the information provided to users of financial statements. The IASB observed that the new requirement does not create significant additional costs for preparers of financial statements because paragraph 67(d) of IFRS 3 already required disclosure of acquisition-related costs.

[*] *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, amended IFRS 3, IFRS 9, IAS 37 and IAS 39 to clarify that contingent consideration in a business combination that is classified as an asset or a liability shall be subsequently measured at fair value with changes in fair value recognised in profit or loss.

(e) **Business combinations achieved in stages**

The revised IFRS 3 establishes the acquisition date as the single measurement date for all assets acquired, liabilities assumed and any non-controlling interest in the acquiree. In a business combination achieved in stages, the acquirer also remeasures its previously held equity interest in the acquiree at its acquisition-date fair value and recognises the resulting gain or loss, if any, in profit or loss. In contrast, IFRS 3 required that for a business combination achieved in stages each exchange transaction should be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. Therefore, the previous treatment required a comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets and liabilities at each step. The IASB concluded that the revised treatment of business combinations achieved in stages would improve understandability and relevance of the information provided as well as reduce the cost of accounting for such transactions.

BC438 The IASB concluded that the guidance in the revised IFRS 3 is not unduly complex. Indeed, it eliminates guidance that many have found to be complex, costly and arbitrary and that has been the source of considerable uncertainties and costs in the marketplace. Moreover, the revised IFRS 3 does not introduce a new method of accounting but rather expands the use of the acquisition-method of accounting that is familiar, has been widely used and for which there is a substantial base of experience. However, the IASB also sought to reduce the costs of applying the revised IFRS 3 by:

(a) requiring particular assets and liabilities (eg those related to deferred taxes and employee benefits) to continue to be measured in accordance with existing accounting standards rather than at fair value;

(b) carrying over the basic requirements of IFRS 3 on contingent liabilities assumed in a business combination into the revised IFRS 3 until the IASB has comprehensively reconsidered the accounting for contingencies in its liabilities project; and

(c) requiring the revised IFRS 3 to be applied prospectively rather than retrospectively.

BC439 The IASB acknowledges that those steps may result in some sacrifice to the benefits of improved information in financial statements in accordance with the revised IFRS 3. However, the IASB concluded that the complexities and related costs that would result from applying the fair value measurement requirement to all assets and liabilities, at this time, and requiring retrospective application are not justified.

*Illustrative Examples and Comparison with SFAS 141(R)*
*Hong Kong Financial Reporting Standard 3 (Revised)*

# Business Combinations

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| Guidance | IFRS 3 (as revised in 2008) | SFAS 141(R) |
|---|---|---|
| Contingent consideration[*] | **Initial classification**<br><br>The revised IFRS 3 and SFAS 141(R) require an acquirer to classify contingent consideration as an asset, a liability or equity on the basis of other IFRSs or US GAAP, respectively. Differences between the related IFRSs and US GAAP might cause differences in the initial classification and, therefore, might cause differences in the subsequent accounting. [the revised IFRS 3, paragraph 40; SFAS 141(R), paragraph 42] | |
| | **Subsequent measurement**<br><br>Contingent consideration classified as an asset or liability that:<br><br>(a) ~~is a financial instrument and~~ is within the scope of ~~IAS 39 *Financial Instruments: Recognition and Measurement*[(c)]~~ IFRS 9 *Financial Instruments*, is measured at fair value at each reporting date~~, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income~~ and changes in fair value shall be recognised in profit or loss in accordance with that IFRS.<br><br>(b) is not within the scope of ~~IAS 39 is accounted for in accordance with IAS 37 or other IFRSs as appropriate~~ IFRS 9, is measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss. [paragraph 58] | **Subsequent measurement**<br><br>Contingent consideration classified as an asset or liability is measured subsequently at fair value. The changes in fair value are recognised in earnings unless the contingent consideration is a hedging instrument for which FASB Statement No. 133 *Accounting for Derivative Instruments and Hedging Activities* requires the subsequent changes to be recognised in other comprehensive income. [paragraph 65] |

[*] *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, amended IFRS 3, IFRS 9, IAS 37 and IAS 39 to clarify that contingent consideration in a business combination that is classified as an asset or a liability shall be subsequently measured at fair value with changes in fair value recognised in profit or loss.

| | |
|---|---|
| Subsequent measurement and accounting for assets, liabilities or equity instruments | In general, after a business combination an acquirer measures and accounts for assets acquired, liabilities assumed or incurred and equity instruments issued in accordance with other applicable IFRSs or US GAAP, depending on their nature. Differences in the other applicable guidance might cause differences in the subsequent measurement and accounting for those assets, liabilities and equity instruments. [the revised IFRS 3, paragraphs 54 and B63; SFAS 141(R), paragraphs 60 and 66] |

The main revisions made in 2008 were:

- The scope was broadened to cover business combinations involving only mutual entities and business combinations achieved by contract alone.

- The definitions of a *business* and a *business combination* were amended and additional guidance was added for identifying when a group of assets constitutes a business.

- For each business combination, the acquirer must measure any non-controlling interest in the acquiree either at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets. Previously, only the latter was permitted.

- The requirements for how the acquirer makes any classifications, designations or assessments for the identifiable assets acquired and liabilities assumed in a business combination were clarified.

- The period during which changes to deferred tax benefits acquired in a business combination can be adjusted against goodwill has been limited to the measurement period (through a consequential amendment to HKAS 12 *Income Taxes*).

- An acquirer is no longer permitted to recognise contingencies acquired in a business combination that do not meet the definition of a liability.

- Costs the acquirer incurs in connection with the business combination must be accounted for separately from the business combination, which usually means that they are recognised as expenses (rather than included in goodwill).

- Consideration transferred by the acquirer, including contingent consideration, must be measured and recognised at fair value at the acquisition date. Subsequent changes in the fair value of contingent consideration classified as liabilities are recognised in ac~~cordance with HKAS 39, HKAS 37 or other HKFRSs, as appropriate~~ profit or loss (rather than by adjusting goodwill)[*]. The disclosures required to be made in relation to contingent consideration were enhanced.

- Application guidance was added in relation to when the acquirer is obliged to replace the acquiree's share-based payment awards; measuring indemnification assets; rights sold previously that are reacquired in a business combination; operating leases; and valuation allowances related to financial assets such as receivables and loans.

- For business combinations achieved in stages, having the acquisition date as the single measurement date was extended to include the measurement of goodwill. An acquirer must remeasure any equity interest it holds in the acquiree immediately before achieving control at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss.

[*] *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, amended IFRS 3, IFRS 9, IAS 37 and IAS 39 to clarify that contingent consideration in a business combination that is classified as an asset or a liability shall be subsequently measured at fair value with changes in fair value recognised in profit or loss.

HKFRS 8
Revised ~~June 2014~~November 2016

Effective for annual periods
beginning on or after 1 January 2009

*Hong Kong Financial Reporting Standard 8*

# Operating Segments

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17 If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, information about that segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability in paragraph 13.

18 If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the criteria for reportability in paragraph 13 in the prior period, unless the necessary information is not available and the cost to develop it would be excessive.

19 There may be a practical limit to the number of reportable segments that an entity separately discloses beyond which segment information may become too detailed. Although no precise limit has been determined, as the number of segments that are reportable in accordance with paragraphs 13-18 increases above ten, the entity should consider whether a practical limit has been reached.

## Disclosure

**20 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.**

21 To give effect to the principle in paragraph 20, an entity shall disclose the following for each period for which a statement of comprehensive income is presented:

(a) general information as described in paragraph 22;

(b) information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, segment liabilities and the basis of measurement, as described in paragraphs 23-27; and

(c) reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts as described in paragraph 28.

Reconciliations of the amounts in the statement of financial position for reportable segments to the amounts in the entity's statement of financial position are required for each date at which a statement of financial position is presented. Information for prior periods shall be restated as described in paragraphs 29 and 30.

### General information

22 An entity shall disclose the following general information:

(a) factors used to identify the entity's reportable segments, including the basis of organisation (for example, whether management has chosen to organise the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether operating segments have been aggregated)~~, and~~;

(aa) the judgements made by management in applying the aggregation criteria in paragraph 12. This includes a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics; and

(b) types of products and services from which each reportable segment derives its revenues.

## Reconciliations

28 An entity shall provide reconciliations of all of the following:

(a) the total of the reportable segments' revenues to the entity's revenue.

(b) 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 the entity's profit or loss after those items.

(c) the total of the reportable segments' assets to the entity's assets if the segment assets are reported in accordance with paragraph 23.

(d) the total of the reportable segments' liabilities to the entity's liabilities if segment liabilities are reported in accordance with paragraph 23.

(e) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

All material reconciling items shall be separately identified and described. For example, the amount of each material adjustment needed to reconcile reportable segment profit or loss to the entity's profit or loss arising from different accounting policies shall be separately identified and described.

## Restatement of previously reported information

29 If an entity changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, shall be restated unless the information is not available and the cost to develop it would be excessive. The determination of whether the information is not available and the cost to develop it would be excessive shall be made for each individual item of disclosure. Following a change in the composition of its reportable segments, an entity shall disclose whether it has restated the corresponding items of segment information for earlier periods.

30 If an entity has changed the structure of its internal organisation in a manner that causes the composition of its reportable segments to change and if segment information for earlier periods, including interim periods, is not restated to reflect the change, the entity shall disclose in the year in which the change occurs segment information for the current period on both the old basis and the new basis of segmentation, unless the necessary information is not available and the cost to develop it would be excessive.

## Entity-wide disclosures

31 Paragraphs 32-34 apply to all entities subject to this HKFRS including those entities that have a single reportable segment. Some entities' business activities are not organised on the basis of differences in related products and services or differences in geographical areas of operations. Such an entity's reportable segments may report revenues from a broad range of essentially different products and services, or more than one of its reportable segments may provide essentially the same products and services. Similarly, an entity's reportable segments may hold assets in different geographical areas and report revenues from customers in different geographical areas, or more than one of its reportable segments may operate in the same geographical area. Information required by paragraphs 32-34 shall be provided only if it is not provided as part of the reportable segment information required by this HKFRS.

## Transition and effective date

35 An entity shall apply this HKFRS in its annual financial statements for periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies this HKFRS in its financial statements for a period before 1 January 2009, it shall disclose that fact.

35A Paragraph 23 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.

36 Segment information for prior years that is reported as comparative information for the initial year of application (including application of the amendment to paragraphs 23 made in May 2009) shall be restated to conform to the requirements of this HKFRS, unless the necessary information is not available and the cost to develop it would be excessive.

36A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 23(f). An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

36B HKAS 24 *Related Party Disclosures* (as revised in 2009) amended paragraph 34 for annual periods beginning on or after 1 January 2011. If an entity applies HKAS 24 (revised 2009) for an earlier period, it shall apply the amendment to paragraph 34 for that earlier period.

36C *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraphs 22 and 28. An entity shall apply those amendments for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

## Withdrawal of HKAS 14

37 This HKFRS supersedes HKAS 14 *Segment Reporting*.

*Basis for Conclusions on*
*Hong Kong Financial Reporting Standard 8*

# Operating Segments

Hong Kong Institute of
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# Basis for Conclusions
# HKFRS 8 *Operating Segments*

HKFRS 8 is based on IFRS 8 *Operating Segments*. In approving HKFRS 8, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 8. Accordingly, there are no significant differences between HKFRS 8 and IFRS 8. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 8 referred to below generally correspond with those in HKFRS 8.

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## DISSENTING OPINIONS ON IFRS 8

## APPENDICES

**A** **Background information and basis for conclusions of the US Financial Accounting Standards Board on SFAS 131**

**B** **Amendments to Basis for Conclusions on other IFRSs**

rule-based, rather than a principle-based, approach. In addition, some respondents commented that the inclusion of a 10 per cent threshold could create a precedent for determining materiality in other areas.

BC29 The Board considered an approach whereby any material operating segment would be required to be disclosed separately. However, the Board was concerned that there might be uncertainty about the meaning of materiality in relation to disclosure. Furthermore, such a requirement would be a significant change from the wording of SFAS 131. Thus, the Board was concerned that the change would be from an easily understandable and familiar set of words that converges with SFAS 131 to a potentially confusing principle. Accordingly, the Board decided to retain the quantitative thresholds.

## Interaction of aggregation criteria and quantitative thresholds

BC30 One respondent commented that the ranking of the aggregation criteria for operating segments and the quantitative thresholds for determining reportable segments was unclear in ED 8. However, the flow chart in paragraph IG7 of the implementation guidance indicates that the aggregation criteria take precedence over the quantitative thresholds. The Board also noted that the wording in SFAS 131 was clear because the paragraph on aggregation refers to aggregation into a “single operating segment”. The quantitative thresholds then determine which operating segments are reportable segments. The term “operating” has been inserted in paragraph 12 of the IFRS.

## Aggregation of operating segments

BC30A The Board received a request to consider including a disclosure in paragraph 22 that would require a description of the operating segments that have been aggregated and the economic indicators that have been assessed to decide whether operating segments have ‘similar economic characteristics’ in accordance with paragraph 12. The Board observed that:

(a) paragraph 12 does not elaborate upon the meaning of “similar economic characteristics” except to say that operating segments that share similar economic characteristics would be expected to exhibit a similar long term financial performance. In addition, determining whether operating segments have similar economic characteristics requires the use of judgement.

(b) paragraph 22(a) currently contains a requirement to disclose the factors used to identify the entity’s reportable segments, including the basis of organisation, and suggests, as an example, disclosing whether operating segments have been aggregated. However, there is no explicit, or indeed apparent, requirement in paragraph 22(a) to disclose the aggregation of operating segments.

BC30B The Board noted that the disclosure is complementary to the information required by paragraph 22(a). The Board thinks that including a disclosure requirement in paragraph 22 would provide users of financial statements with an understanding of the judgements made by management on how (and the reasons why) operating segments have been aggregated. The judgements made by management may relate to the application of any of the criteria in paragraph 12, which states that two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8, the segments have similar economic characteristics and the segments are similarly based on the factors listed in paragraph 12(a)–(e). Consequently, the Board added paragraph 22(aa) to complement the disclosure required in paragraph 22(a). The requirements in paragraph 22(b) remain the same and its wording has not been modified.

## Inclusion of US guidance

BC31 The Board discussed the extent to which the IFRS should address the practical problems that have arisen from applying SFAS 131 in the US. The Board considered the FASB *Q&A 131 Segment Information: Guidance on Applying Statement 131* and Emerging Issues Task Force (EITF) 04-10 *Determining Whether to Aggregate Operating Segments that do not Meet the Quantitative Threshold*.

BC32 EITF 04-10 addresses the issue of whether to aggregate operating segments that do not meet the quantitative thresholds. It requires quantitative thresholds to be aggregated only if aggregation is consistent with the objective and core principles of SFAS 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in paragraph 17(a)-(e) of SFAS 131. The Board agreed with the approach adopted in EITF 04-10 and concluded that the same requirement should be included in the IFRS.

BC33 FASB *Q&A 131-Segment Information: Guidance on Applying Statement 131* is an implementation guide that provides the views of the FASB staff on certain questions on SFAS 131. Because it was not issued by the FASB itself, the Board decided not to include this material in the IFRS.

## Information about segment assets

BC34 Several respondents noted that, whilst a measure of segment profit or loss can be expected in every entity's internal reporting, a measure of segment assets is not always available, particularly in service industries or other industries with low utilisation of physical assets. Respondents suggested that in such circumstances a measure of segment assets should be disclosed only if those amounts were regularly provided to the chief operating decision maker.

BC35 [Not used]

BC35A After IFRS 8 was issued, the Board was informed that the reasons originally set out in paragraph BC35 contradict long-standing interpretations published in the US for the application of SFAS 131 and create an unintended difference from practice in the US under SFAS 131. After reconsideration and discussion of the interaction between the disclosure and measurement requirements in the IFRS (paragraphs 23 and 25), the Board concluded that those reasons no longer reflected its thinking. Therefore, the Board amended paragraph 23 by *Improvements to IFRSs* issued in April 2009 to clarify that a measure of segment assets should be disclosed only if that amount is regularly provided to the chief operating decision maker.

## Reconciliation of segment assets

BC35B The Board received a request to clarify in paragraph 28(c) that a reconciliation of the total of the reportable segments' assets to the entity's assets should only be disclosed if that amount is regularly provided to the chief operating decision maker. This clarification would make this paragraph consistent with paragraphs 23 and 28(d). The Board agreed with the request and decided to modify paragraph 28(c) to achieve this.

## Information about segment liabilities

BC36 ED 8 did not propose disclosure of segment liabilities because there is no such requirement in SFAS 131. The reasons for this are set out in paragraph 96 of the Basis for Conclusions on SFAS 131, included as Appendix A to this Basis for Conclusions.

BC37 Some respondents proposed adding a requirement for each entity to disclose information about segment liabilities, if such information is regularly provided to the chief operating decision maker. They argued that information about segment liabilities would be helpful to users. Other respondents favoured information about net segment assets rather than gross segment assets.

BC38 The Board noted that if segment liabilities are considered in assessing the performance of, and allocating resources to, the segments of an entity, such disclosure would be consistent with the management approach. The Board also noted support for this disclosure from some commentators, particularly users of financial statements. Accordingly the Board decided to require disclosure of a measure of segment liabilities if those amounts are regularly provided to the chief operating decision maker notwithstanding that such a requirement would create divergence from SFAS 131.

## Level of reconciliations

BC39 ED 8 proposed that an entity should provide reconciliations of total reportable segment amounts for specified items to amounts the entity recognised in accordance with IFRSs. It did not propose such reconciliations for individual reportable segments.

BC40 Several respondents expressed concern about the level of detail provided by the proposed reconciliations. They argued that if the IFRS allows segment information to be measured on the basis of management information, it should require reconciliations for individual reportable segments between the segment amounts and the equivalent amounts measured in accordance with an entity's IFRS accounting policies. They added that reconciling only total reportable segment amounts to amounts presented in the financial statements does not provide useful information.

HKFRS 13
~~Issued June 2011~~Revised November 2016

Effective for annual periods
beginning on or after 1 January 2013

*Hong Kong Financial Reporting Standard 13*

# Fair Value Measurement

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51 An entity shall make an accounting policy decision in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to use the exception in paragraph 48. An entity that uses the exception shall apply that accounting policy, including its policy for allocating bid-ask adjustments (see paragraphs 53–55) and credit adjustments (see paragraph 56), if applicable, consistently from period to period for a particular portfolio.

52 The exception in paragraph 48 applies only to financial assets, ~~and~~ financial liabilities and other contracts within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement* or HKFRS 9 *Financial Instruments*. The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, HKAS 39 or HKFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities in HKAS 32 *Financial Instruments: Presentation*.

## Exposure to market risks

53 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities managed on the basis of the entity's net exposure to a particular market risk (or risks), the entity shall apply the price within the bid-ask spread that is most representative of fair value in the circumstances to the entity's net exposure to those market risks (see paragraphs 70 and 71).

54 When using the exception in paragraph 48, an entity shall ensure that the market risk (or risks) to which the entity is exposed within that group of financial assets and financial liabilities is substantially the same. For example, an entity would not combine the interest rate risk associated with a financial asset with the commodity price risk associated with a financial liability because doing so would not mitigate the entity's exposure to interest rate risk or commodity price risk. When using the exception in paragraph 48, any basis risk resulting from the market risk parameters not being identical shall be taken into account in the fair value measurement of the financial assets and financial liabilities within the group.

55 Similarly, the duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities shall be substantially the same. For example, an entity that uses a 12-month futures contract against the cash flows associated with 12 months' worth of interest rate risk exposure on a five-year financial instrument within a group made up of only those financial assets and financial liabilities measures the fair value of the exposure to 12-month interest rate risk on a net basis and the remaining interest rate risk exposure (ie years 2–5) on a gross basis.

## Exposure to the credit risk of a particular counterparty

56 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities entered into with a particular counterparty, the entity shall include the effect of the entity's net exposure to the credit risk of that counterparty or the counterparty's net exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure in the event of default (eg a master netting agreement with the counterparty or an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party). The fair value measurement shall reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

# Appendix C
# Effective date and transition

*This appendix is an integral part of the HKFRS and has the same authority as the other parts of the HKFRS.*

C1 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this HKFRS for an earlier period, it shall disclose that fact.

C2 This HKFRS shall be applied prospectively as of the beginning of the annual period in which it is initially applied.

C3 The disclosure requirements of this HKFRS need not be applied in comparative information provided for periods before initial application of this HKFRS.

C4 *Annual Improvements Cycle 2011–2013* issued in January 2014 amended paragraph 52. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. An entity shall apply that amendment prospectively from the beginning of the annual period in which HKFRS 13 was initially applied. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

HKFRS 13 BC
Revised November ~~2014~~ 2016

*Basis for Conclusions on*
*Hong Kong Financial Reporting Standard 13*

# Fair Value Measurement

Hong Kong Institute of
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# Basis for Conclusions
# HKFRS 13 *Fair Value Measurement*

HKFRS 13 is based on IFRS 13 *Fair Value Measurement*. In approving HKFRS 13, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 13. Accordingly, there are no significant differences between HKFRS 13 and IFRS 13. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 13 referred to below generally correspond with those in HKFRS 13.

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BC118 Consequently, the boards decided to permit an exception to the requirements in IFRS 13 and Topic 820 for measuring fair value when an entity manages its financial assets and financial liabilities on the basis of the entity's net exposure to market risks or to the credit risk of a particular counterparty. Respondents to the FASB's proposed ASU generally supported that proposal and stated that it was consistent with current practice for measuring the fair value of such financial assets and financial liabilities.

BC119 That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie asset) for a particular risk exposure or to transfer a net short position (ie liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions, subject to specific requirements.

### *Scope of paragraph 52*

BC119A After issuing IFRS 13, the IASB was made aware that it was not clear whether the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the 'portfolio exception') includes all contracts that are within the scope of IAS 39 or IFRS 9. The exception is set out in paragraph 48 and the scope of the exception is set out in paragraph 52. In particular, the IASB was asked whether the scope of the portfolio exception included contracts that are accounted for as if they were financial instruments, but that do not meet the definitions of financial assets or financial liabilities in IAS 32. Examples of such a situation would be some contracts to buy or sell a non-financial item that can be settled net in cash by another financial instrument or by exchanging financial instruments as if the contracts were financial instruments within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9.

BC119B The IASB did not intend to exclude from the scope of the portfolio exception any contracts that are within the scope of IAS 39 or IFRS 9. Consequently, the IASB amended paragraph 52 of this Standard to clarify that the portfolio exception applies to all contracts within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32.

### *Evidence of managing financial instruments on the basis of the net risk exposure*

BC120 IFRS 13 states that to use the exception, an entity must provide evidence that it consistently manages its financial instruments on the basis of its net exposure to market risks or credit risk. In addition, the entity must be required (or must have elected, for example, in accordance with the fair value option) to measure the financial instruments at fair value on a recurring basis. The boards concluded that if an entity does not manage its risk exposure on a net basis and does not manage its financial instruments on a fair value basis, the entity should not be permitted to measure the fair value of its financial instruments on the basis of the entity's net risk exposure.

BC121 The boards decided to require an entity to provide evidence that it manages its net risk exposure consistently from period to period. The boards decided this because an entity that can provide evidence that it manages its financial instruments on the basis of its net risk exposure would do so consistently for a particular portfolio from period to period, and not on a net basis for that portfolio in some periods and on a gross basis in other periods. Some respondents to the FASB's proposed ASU found that requirement limiting because they noted that the composition of a portfolio changes continually as the entity rebalances the portfolio and changes its risk exposure preferences over time. Although the entity does not need to maintain a static portfolio, the boards decided to clarify that the entity must make an accounting policy decision (in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) to use the exception described in paragraphs BC118 and BC119. The boards also decided that the accounting policy decision could be changed if the entity's risk exposure preferences change. In that case the entity can decide not to use the exception but instead to measure the fair value of its financial instruments on an individual instrument basis. However, if the entity continues to value a portfolio using the exception, it must do so consistently from period to period.

### *Exposure to market risks*

BC122 The boards decided that an entity could apply the bid-ask spread guidance to the entity's net position in a particular market risk (rather than to each individual financial instrument included in that position) only if the market risks that are being offset are substantially the same. Some respondents to the FASB's proposed ASU asked for additional guidance on what is meant by *substantially the same* given the different instruments and types of instruments that might make up a portfolio. In addition, they were concerned that the proposed requirement that the market risks be substantially the same meant that there could be no basis risk in the portfolio or, conversely, that the basis risk would not be reflected in the fair value measurement.

BC123 Consequently, the boards decided to include additional guidance for determining whether market risks are substantially the same. The boards held discussions with several financial institutions that manage their financial assets and financial liabilities on the basis of their net exposure to market risks. From those discussions, the boards concluded that when measuring fair value on the basis of an entity's net exposure to market risks, the entity should not combine a financial asset that exposes it to a particular market risk with a financial liability that exposes it to a different market risk that does not mitigate either of the market risk exposures that the entity faces. The boards also concluded that it is not necessary that the grouping of particular financial assets and financial liabilities results in an entity having no basis risk because the fair value measurement would take into account any basis risk. Furthermore, on the basis of their discussions with financial institutions, the boards concluded that an entity should not combine a financial asset that exposes it to a particular market risk over a particular duration with a financial liability that exposes it to substantially the same market risk over a different duration without taking into account the fact that the entity is fully exposed to that market risk over the time period for which the market risks are not offset. If there is a time period in which a market risk is not offset, the entity may measure its net exposure to that market risk over the time period in which the market risk is offset and must measure its gross exposure to that market risk for the remaining time period (ie the time period in which the market risk is not offset).

### *Exposure to the credit risk of a particular counterparty*

BC124 Because the bid-ask spread (which is the basis for making adjustments for an entity's exposure to market risk to arrive at the fair value of the net position) does not include adjustments for counterparty credit risk (see paragraph BC164), the boards decided to specify that an entity may take into account its net exposure to the credit risk of a particular counterparty when applying the exception.

BC125 The boards decided that when measuring fair value, an entity may consider its net exposure to credit risk when it has entered into an arrangement with a counterparty that mitigates its credit risk exposure in the event of default (eg a master netting agreement). On the basis of their discussions with financial institutions the boards concluded that a fair value measurement reflects market participants' expectations about the likelihood that such an arrangement would be legally enforceable.

BC126 Some respondents to the FASB's proposed ASU asked whether the existence of a master netting agreement was necessary or whether other credit mitigating arrangements could be taken into account in the fair value measurement. The boards decided to clarify that in a fair value measurement, an entity must take into account other arrangements that mitigate credit risk, such as an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party, if market participants would expect such arrangements to be legally enforceable in the event of default.

BC127 The boards acknowledged that the group of financial assets and financial liabilities for which an entity manages its net exposure to a particular market risk (or risks) could differ from the group of financial assets and financial liabilities for which an entity manages its net exposure to the credit risk of a particular counterparty because it is unlikely that all contracts would be with the same counterparty.

BC134 Some respondents suggested that market inactivity should be included in the list of indicators. The boards concluded that market inactivity is not an indicator that the transaction price may not represent fair value, but an indicator that the entity should do further work to determine whether the transaction price represents fair value.

BC135 The exposure draft did not address the recognition of a day 1 gain or loss but stated that an entity would recognise such gains or losses unless another IFRS specifies otherwise. For example, IAS 39 and IFRS 9 state that an entity cannot recognise a day 1 gain or loss for a financial instrument unless its fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets. In contrast, IFRS 3 and IAS 41 require the recognition of day 1 gains or losses even when fair value is measured using unobservable inputs.

BC136 The IASB concluded that fair value should be measured at initial recognition without regard to whether it would result in a gain or loss at initial recognition of the asset or liability. Respondents' views ranged from the view that the transaction price is the best evidence of fair value at initial recognition unless the fair value is measured using only observable inputs (the approach in IAS 39 and IFRS 9) to the view that the transaction price might sometimes, but not always, represent fair value at initial recognition, and that the degree of observability of inputs is not always the best indicator of whether this is the case (the approach in US GAAP).

BC137 Many respondents suggested that IFRSs and US GAAP should have the same requirements for recognising gains or losses at initial recognition. The boards concluded that determining whether to recognise a day 1 gain or loss was beyond the scope of the fair value measurement project. The boards noted that the measurement basis at initial recognition of financial instruments in IFRSs and US GAAP is not always the same, and so the boards could not address comparability at this time. As a result, the boards decided that an entity would refer to relevant IFRSs for the asset or liability when determining whether to recognise those amounts. The boards concluded that if the relevant IFRS does not specify whether and, if so, where to recognise those amounts, the entity should recognise them in profit or loss.

BC138 Although the IASB did not change the recognition threshold, it amended IAS 39 and IFRS 9 to clarify that the fair value of financial instruments at initial recognition should be measured in accordance with IFRS 13 and that any deferred amounts arising from the application of the recognition threshold in IAS 39 and IFRS 9 are separate from the fair value measurement. In other words, the recognition threshold in IAS 39 and IFRS 9 is not a constraint when measuring fair value. Rather, it determines whether (and when) the resulting difference (if any) between fair value at initial recognition and the transaction price is recognised.

## Short-term receivables and payables

BC138A After issuing IFRS 13, the IASB was made aware that an amendment to IFRS 9 and IAS 39, which resulted in the deletion of paragraphs B5.4.12 and AG79 respectively, might be perceived as removing the ability to measure short-term receivables and payables with no stated interest rate at invoice amounts without discounting, when the effect of not discounting is immaterial. The IASB did not intend to change the measurement requirements for those short-term receivables and payables, noting that paragraph 8 of IAS 8 already permits entities not to apply accounting policies set out in accordance with IFRSs when the effect of applying them is immaterial.

## Valuation techniques

BC139 When measuring fair value, the objective of using a valuation technique is to estimate the price at which an orderly transaction would take place between market participants at the measurement date under current market conditions.

BC140 To meet that objective, the exposure draft proposed that valuation techniques used to measure fair value should be consistent with the market approach, income approach or cost approach. Such valuation techniques are consistent with those already described in IFRSs and with valuation practice.

BC141 Respondents generally agreed with the descriptions of the three valuation techniques. Some respondents questioned whether a cost approach is consistent with an exit price definition of fair value because they think that the cost to replace an asset is more consistent with an entry price than an exit price. The IASB noted that an entity's cost to replace an asset would equal the amount that a market participant buyer of that asset (that would use it similarly) would pay to acquire it (ie the entry price and the exit price would be equal in the same market). Thus, the IASB concluded that the cost approach is consistent with an exit price definition of fair value.

### Single versus multiple valuation techniques

BC142 IFRS 13 does not contain a hierarchy of valuation techniques because particular valuation techniques might be more appropriate in some circumstances than in others. The IASB concluded that determining the appropriateness of valuation techniques in the circumstances requires judgement and noted that Topic 820 and the fair value measurement guidance already in IFRSs do not contain a hierarchy of valuation techniques. For example, IAS 41 acknowledged that in some cases the various approaches used by an entity might suggest different fair value conclusions for a biological asset or agricultural produce, but that the entity should consider the reasons for the differences to arrive at a fair value within a reasonable range.

### Valuation adjustments

BC143 Some respondents asked for more explicit requirements about applying valuation adjustments (including risk adjustments related to the uncertainty inherent in the inputs used in a fair value measurement; see paragraphs BC149 and BC150). They found the descriptions of valuation adjustments in the IASB's Fair Value Expert Advisory Panel's October 2008 report *Measuring and disclosing the fair value of financial instruments in markets that are no longer active* helpful (see paragraph BC177). In addition, regulators asked the IASB to address measurement uncertainty to ensure that fair value measurements are not overstated or understated in the statement of financial position, thus improving the quality of information available to users of financial statements.

BC144 Although the exposure draft was not explicit with respect to valuation adjustments, it stated that an entity must use the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique or in the inputs to the valuation technique. That implicitly included measurement uncertainty.

BC145 The boards noted that entities found the IASB's Fair Value Expert Advisory Panel's report helpful when measuring the fair value of financial instruments during a period of market inactivity. As a result, the boards decided to describe the valuation adjustments that entities might need to make when using a valuation technique because market participants would make those adjustments when pricing a financial asset or financial liability under the market conditions at the measurement date, including adjustments for measurement uncertainty. Those valuation adjustments include the following:

(a) an adjustment to a valuation technique to take into account a characteristic of an asset or a liability that is not captured by the valuation technique (the need for such an adjustment is typically identified during calibration of the value calculated using the valuation technique with observable market information).

BC226 The IASB concluded that although IFRS 13 is a major new standard, it does not require any new fair value measurements and it does not fundamentally change many of the requirements for measuring fair value or for disclosing information about those measurements. The IASB concluded that in many respects, IFRS 13 uses different words to articulate the concepts already present in IFRSs. However, the IASB also considered the time that a particular country might require for translation and for introducing the mandatory requirements into law.

BC227 Consequently, the IASB decided that IFRS 13 should be effective for annual periods beginning on or after 1 January 2013. Because IFRS 13 applies when other IFRSs require or permit fair value measurements (and does not introduce any new fair value measurements), the IASB believes that the extended transition period for IFRS 13 provides enough time for entities, their auditors and users of financial statements to prepare for implementation of its requirements.

BC228 The IASB decided to permit early application of IFRS 13 because that would allow entities to apply the measurement and disclosure requirements as soon as practicable, thereby improving comparability in measurement and transparency in disclosures. That would also improve comparability with entities applying US GAAP.

BC229 The exposure draft proposed prospective application because the IASB concluded that a change in the methods used to measure fair value would be inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, eg through better insight or improved judgement). Respondents to the exposure draft and the Request for Views supported that proposal. Therefore, the IASB concluded that IFRS 13 should be applied prospectively (in the same way as a change in accounting estimate).

BC230 To achieve comparability in future periods, the IASB decided to require the disclosures in IFRS 13 for the first interim period in which the IFRS is initially applied. However, those disclosures need not be presented in periods before initial application of the IFRS because it would be difficult to apply some of the requirements in IFRS 13 without the use of hindsight in selecting the inputs that would have been appropriate in prior periods.

BC230A *Annual Improvements Cycle 2011–2013* issued in December 2013 amended paragraph 52 and added paragraph C4 to clarify the scope of the portfolio exception. It considered the transition provisions and effective date of the amendments to IFRS 13. It decided that an entity should apply that amendment for annual periods beginning on or after 1 July 2014. In order to be consistent with the prospective initial application of IFRS 13, the IASB decided that an entity would apply the amendment to IFRS 13 prospectively from the beginning of the annual period in which IFRS 13 was initially applied.

## Application in emerging and transition economies

BC231 During the development of IFRS 13, the IASB received information from entities in emerging and transition economies that had concerns about applying the fair value measurement principles in IFRS 13 in their jurisdictions. Common concerns included the following:

(a) The fair value measurement guidance is not detailed enough to allow them to measure fair value on a consistent basis.

(b) There is limited availability of practitioners in their jurisdictions who have the skills to apply the guidance (and as a result entities might be unfamiliar with applying the necessary judgements).

(c) There is limited access to market data to develop fair value measurements because there are few deep and liquid markets, there are often few willing buyers and sellers and prices often fluctuate considerably within short periods of time.

HK(IFRIC)-Int 14
Revised ~~May 2014~~November 2016

Effective for annual periods beginning on or after 1 January 2008

*HK (IFRIC) Interpretation 14*

# HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

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IE17 In this example there is no prepayment as described in paragraph 20(a). The amounts available as a reduction in future contributions when applying paragraph 20(b) are set out below.

| Year | IAS 19 service cost | Minimum contributions required to cover future service | Amount available as contribution reduction |
|---|---|---|---|
| 1 | 13 | 15 | (2) |
| 2 | 13 | 13 | 0 |
| 3 | 13 | 11 | 2 |
| 4+ | 13 | 9 | 4 |

IE18 Assuming a discount rate of 6 per cent, the present value of the economic benefit available as a future contribution reduction is therefore equal to:

$(2)/(1.06) + 0/(1.06)^2 + 2/(1.06)^3 + 4/(1.06)^4 \ldots. = 56.$

Thus in accordance with paragraph 58(b) of IAS 19, the present value of the economic benefit available from future contribution reductions is limited to 56.

IE19 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the additional contributions payable will not be fully available. Therefore, the effect of the asset ceiling is 294 (50 + 300 - 56).

IE20 The entity recognises a net defined benefit liability of 244 in the statement of financial position. No other liability is recognised in respect of the obligation to make contributions to fund the minimum funding shortfall.

## Summary

| | |
|---|---|
| Surplus | 50 |
| Net defined benefit asset (before consideration of the minimum funding requirement) | 50 |
| Effect of the asset ceiling | (294) |
| Net defined benefit liability | (244) |

IE21 When the contributions of 300 are paid into the plan, the net defined benefit asset ~~recognised in the statement of financial position~~ will become 56 (300 - 244).