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

MEMBERS' HANDBOOK

Update No. 240

(Issued 29 June 2020)

This Update relates to the publication of *Annual Improvements to HKFRSs 2018-2020* and narrow-scope amendments to three HKFRS Standards.

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard existing pages i-ii and replace with revised pages i-ii.	Revised contents pages
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
Annual Improvements to HKFRSs 2018-2020	Insert these pages after *HKFRS 17 Insurance Contracts*	Refer to Note 1
HKFRS 3 (Revised) *Business Combinations*	Replace the cover page, and pages 1A, 3 and 4 with revised cover page, and revised pages 1A, 3 and 4. Insert pages 48-50 after page 47.	Refer to Note 2
HKFRS 3 (Revised) *Business Combinations* (Basis for Conclusions)	Replace the cover page, and page 5 with revised cover page, and revised page 5. Insert pages 106-109 after page 105.	Refer to Note 2
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 16 *Property, Plant and Equipment*	Replace the cover page, and pages 2, 4 and 22A with revised cover page, and revised pages 2, 4 and 22A. Insert pages 21A and 21B after page 21, insert page 22B after page 22A and insert pages 43A-43D after page 43.	Refer to Note 3
HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	Replace the cover page, and pages 2 and 4 with revised cover page, and revised pages 2 and 4. Insert pages 31-36 after page 30.	Refer to Note 4

Note:

1. The following table lists the HKFRS Standards amended and the topics addressed by *Annual Improvements to HKFRSs 2018-2020*.

Standard	**Subject of amendment**
HKFRS 1 *First-time Adoption of International Financial Reporting Standards*	Subsidiary as a First-time Adopter
HKFRS 9 *Financial Instruments*	Fees in the ‘10 per cent’ Test for Derecognition of Financial Liabilities
Illustrative Examples accompanying HKFRS 16 *Leases*	Lease Incentives
HKAS 41 *Agriculture*	Taxation in Fair Value Measurements

2. The amendments update a reference in HKFRS 3 to the *Conceptual Framework for Financial Reporting* issued in 2018. The amendments also add to HKFRS 3 an exception to its requirement for an entity to refer to the *Conceptual Framework* to determine what constitutes an asset or a liability. The exception specifies that, for some types of liabilities and contingent liabilities, an entity applying HKFRS 3 should instead refer to HKAS 37. The exception has been added to avoid an unintended consequence of updating the reference.

3. The amendments clarify the accounting requirements for proceeds received by an entity from selling items produced while testing an item of property, plant or equipment before it is used for its intended purpose. An entity recognises the proceeds from selling any such items, and the cost of those items, in profit or loss and measures the cost of those items applying the measurement requirements of HKAS 2.

4. The amendments clarify that for the purpose of assessing whether a contract is onerous under HKAS 37, the cost of fulfilling the contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract include both the incremental costs of fulfilling that contract (for example, direct labour and materials) and an allocation of other costs that relate directly to fulfilling contracts (for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract).

5. All amendments are effective 1 January 2022. Earlier application is permitted.

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Hong Kong Financial Reporting Standard

Annual Improvements to HKFRSs 2018-2020

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The Standards amended

The following table shows the Standards amended and the subjects of the amendments.

Standard	**Subject of amendment**
HKFRS 1 *First-time Adoption of International Financial Reporting Standards*	Subsidiary as a First-time Adopter
HKFRS 9 *Financial Instruments*	Fees in the '10 per cent' Test for Derecognition of Financial Liabilities
Illustrative Examples accompanying HKFRS 16 *Leases*	Lease Incentives
HKAS 41 *Agriculture*	Taxation in Fair Value Measurements

Amendment to HKFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph 39AG and, in Appendix D, paragraph D13A are added. Paragraph D1(f) is amended. New text is underlined and deleted text is struck through.

Effective date

...

39AG *Annual Improvements to HKFRS Standards 2018–2020*, issued in June 2020, amended paragraph D1(f) and added paragraph D13A. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

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Appendix D
Exemptions from other HKFRSs

This appendix is an integral part of the HKFRS.

D1 An entity may elect to use one or more of the following exemptions:

...

(f) cumulative translation differences (paragraphs D12–D13A ~~and D13~~);

...

Cumulative translation differences

...

D13A Instead of applying paragraph D12 or paragraph D13, a subsidiary that uses the exemption in paragraph D16(a) may elect, in its financial statements, to measure cumulative translation differences for all foreign operations at the carrying amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to HKFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. A similar election is available to an associate or joint venture that uses the exemption in paragraph D16(a).

...

Amendment to Basis for Conclusion on IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph BC30(d) is amended. New text in this paragraph is underlined.

After paragraph BC55, a new heading and paragraphs BC55A–BC55C are added. These paragraphs and their related heading have not been underlined for ease of reading.

BC30 An entity may elect to use one or more of the following exemptions:

...

(d) cumulative translation differences (paragraphs BC53–<u>BC55C</u>~~BC55~~);

...

Subsidiary as a First-time Adopter (Annual Improvements to IFRS Standards 2018–2020)

BC55A Paragraph D16(a) provides a subsidiary that becomes a first-time adopter later than its parent with an exemption relating to the measurement of its assets and liabilities. Paragraphs BC59–BC60 explain that the Board provided this exemption so that a subsidiary would not have to keep two parallel sets of accounting records based on different dates of transition to IFRSs.

BC55B The exemption in paragraph D16(a) does not apply to components of equity. Accordingly, before the amendment that added paragraph D13A, a subsidiary that became a first-time adopter later than its parent might have been required to keep two parallel sets of accounting records for cumulative translation differences based on different dates of transition to IFRSs. Following the rationale in paragraphs BC59–BC60, the Board decided to extend the exemption in paragraph D16(a) to cumulative translation differences to reduce costs for first-time adopters. The Board noted that IFRS 1 already provides an exemption relating to cumulative translation differences. Extending the exemption in paragraph D16(a) would therefore not diminish the relevance of information reported by a subsidiary that becomes a first-time adopter later than its parent.

BC55C Entities that apply paragraph D16(a) could in some situations find it burdensome to measure cumulative translation differences using the amount reported by the parent. The Board therefore decided to permit, but not require, a subsidiary applying paragraph D16(a) to use that exemption for cumulative translation differences. The amendment also applies to an associate or joint venture that uses the exemption in paragraph D16(a).

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Amendment to HKFRS 9 *Financial Instruments*

Paragraph 7.1.9, paragraph 7.2.35 and its heading, and paragraph B3.3.6A are added. Paragraph B3.3.6 is amended. New text is underlined. The requirements in paragraph B3.3.6A have not been amended but have been moved from paragraph B3.3.6.

Chapter 7 Effective date and transition

7.1 Effective date

...

7.1.9 *Annual Improvements to HKFRS Standards 2018–2020*, issued in June 2020, added paragraphs 7.2.35 and B3.3.6A and amended paragraph B3.3.6. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

7.2 Transition

...

Transition for Annual Improvements to HKFRS Standards

7.2.35 An entity shall apply *Annual Improvements to HKFRS Standards 2018–2020* to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

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Appendix B
Application Guidance

This appendix is an integral part of the Standard.

...

Recognition and derecognition (Chapter 3)

...

Derecognition of financial liabilities (Section 3.3)

...

B3.3.6 For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. In determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf.

B3.3.6A If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

...

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Amendment to Basis for Conclusions on IFRS 9 *Financial Instruments*

After paragraph BC3.32, a new heading and paragraphs BC3.33–BC3.36 are added. These paragraphs and their related heading have not been underlined for ease of reading.

Fees in the '10 per cent' Test for Derecognition of Financial Liabilities (*Annual Improvements to IFRS Standards 2018–2020*)

BC3.33 Paragraph 3.3.2 requires an entity to derecognise the original financial liability and recognise a new financial liability when there is:

(a) an exchange between an existing borrower and lender of debt instruments with substantially different terms; or

(b) a substantial modification of the terms of an existing financial liability or a part of it.

Paragraph B3.3.6 specifies that the terms are substantially different if the discounted present value of the cash flows under the new terms using the original effective interest rate is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability (10 per cent test). Paragraph B3.3.6 requires an entity to include 'any fees paid net of any fees received' in the 10 per cent test.

BC3.34 The Board decided to amend paragraph B3.3.6 in response to a request to clarify which fees an entity includes in the 10 per cent test. The clarification aligns with the objective of the test, which is to quantitatively assess the significance of any difference between the old and new contractual terms on the basis of the changes in the contractual cash flows between the borrower and lender.

BC3.35 The transition requirements in paragraph 7.2.35 reflect the Board's view that the expected benefit from retrospective application of the amendment would not outweigh the cost of requiring entities to reassess all previous modifications and exchanges. In particular, retrospective application would be unlikely to provide users of financial statements with trend information because financial liabilities are generally modified or exchanged on an ad hoc basis.

BC3.36 Paragraph AG62 of IAS 39 includes the same requirements as those in paragraph B3.3.6 of IFRS 9. An entity that has not previously applied any version of IFRS 9 and whose activities are predominantly connected with insurance is permitted to apply IAS 39 for a limited period of time. In providing the temporary exemption from applying IFRS 9, the Board had not contemplated maintaining IAS 39 (other than for hedge accounting) given the temporary and limited nature of the exemption. Therefore, the Board did not amend paragraph AG62 of IAS 39.

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Amendment to
Illustrative Examples accompanying HKFRS 16 *Leases*

Part 1 of Illustrative Example 13 in paragraph IE5 is amended. New text is underlined and deleted text is struck through.

Lessee measurement (paragraphs 18–41 and B34–B41)

IE5 ...

Example 13—Measurement by a lessee and accounting for a change in the lease term

Part 1—Initial measurement of the right-of-use asset and the lease liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000 ~~and Lessee's leasehold improvements of CU7,000~~.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives the lease incentive ~~incentives~~ from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	
Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	
Right-of-use asset		CU5,000

~~Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant Standards and not as a lease incentive applying IFRS 16. This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the right-of-use asset.~~

...

Amendment to the Basis for Conclusions on IFRS 16 *Leases*

After paragraph BC173, a new heading and paragraphs BC173A–BC173B are added. These paragraphs and their related heading have not been underlined for ease of reading.

Lease Incentives (Annual Improvements to IFRS Standards 2018–2020)

BC173A The Board was informed about the potential for confusion in applying IFRS 16 because of the way Illustrative Example 13 accompanying IFRS 16 had illustrated the requirements for lease incentives. Before the amendment, Illustrative Example 13 had included as part of the fact pattern a reimbursement relating to leasehold improvements; the example had not explained clearly enough the conclusion as to whether the reimbursement would meet the definition of a lease incentive in IFRS 16.

BC173B The Board decided to remove the potential for confusion by deleting from Illustrative Example 13 the reimbursement relating to leasehold improvements. The Board concluded that little would be lost by deleting it.

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Amendment to HKAS 41 *Agriculture*

Paragraph 22 is amended and paragraph 65 is added. New text is underlined and deleted text is struck through.

Recognition and measurement

...

22 An entity does not include any cash flows for financing the assets~~, taxation,~~ or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).

...

Effective date and transition

...

65 *Annual Improvements to HKFRS Standards 2018–2020*, issued in June 2020, amended paragraph 22. An entity shall apply that amendment to fair value measurements on or after the beginning of the first annual reporting period beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

Amendment to the Basis for Conclusions on IAS 41 *Agriculture*

Paragraph BC1 and the headings above paragraph BC5 and BC8 are amended. New text in this paragraph and in these headings is underlined and deleted text is struck through.

After paragraph BC10, a new heading and paragraphs BC11–BC12 are added. These paragraphs and their related heading have not been underlined for ease of reading.

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on amending IAS 41 *Agriculture*, including by issuing ~~*Improvements to IFRSs* in May 2008 and by~~ *Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41)[1] in June 2014 ...

...

Recognition and measurement ~~– 2008 amendments~~

Discount rate (paragraph 20) – 2008 amendments

...

Additional biological transformation (paragraph 21) – 2008 amendments

...

Taxation in Fair Value Measurements – 2020 amendment

BC11 The 2008 amendments removed the requirement for entities to use a pre-tax discount rate to discount cash flows when measuring fair value (see paragraphs BC5–BC7). At that time the Board did not amend paragraph 22 of IAS 41 to delete the reference to cash flows for taxation. Consequently, before *Annual Improvements to IFRS Standards 2018–2020*, IAS 41 had required an entity to use pre-tax cash flows when measuring fair value but did not require the use of a pre-tax discount rate to discount those cash flows.

BC12 In 2020, the Board amended paragraph 22 to remove the requirement to exclude cash flows for taxation when measuring fair value because:

(a) doing so aligns the requirements in IAS 41 on fair value measurement with those in IFRS 13 *Fair Value Measurement*. When measuring fair value, IFRS 13 neither prescribes the use of a single present value technique nor limits the use of present value techniques to only those discussed in that Standard. However, when using a present value technique, paragraph B14 of IFRS 13 requires assumptions about cash flows and discount rates to be internally consistent. Depending on the particular facts and circumstances, an entity applying a present value technique might measure fair value by discounting after-tax cash flows using an after-tax discount rate or pre-tax cash flows at a rate consistent with those cash flows.

(b) it would appear the Board's intention in amending IAS 41 in 2008 was to permit entities to include tax cash flows in measuring fair value (see paragraph BC6). Removing 'taxation' from paragraph 22 is consistent with that intent.

HKFRS 3 (Revised)
Revised ~~July 2019~~June 2020

Effective for annual periods
beginning on or after 1 July 2009

Hong Kong Financial Reporting Standard 3 (Revised)

Business Combinations

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BASIS FOR CONCLUSIONS

ILLUSTRATIVE EXAMPLES

Hong Kong Financial Reporting Standard 3 *Business Combinations* (HKFRS 3) is set out in paragraphs 1 – 68 and Appendices A – C, ~~and~~ E and F. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the HKFRS. HKFRS 3 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

This revised Standard was issued in March 2008. It supersedes HKFRS 3 issued in 2004, as amended in 2005 and 2007.

Appendix F
Reference to the Conceptual Framework
(Amendments to HKFRS 3 *Business Combinations*)

The following sets out amendments required for this Standard resulting from amendments to HKFRS 3 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted.

Paragraph 11 is amended and the footnote to *Framework for the Preparation and Presentation of Financial Statements* in paragraph 11 is deleted. Paragraphs 14, 21, 22 and 23 are amended and paragraphs 21A, 21B, 21C, 23A and 64Q are added. A heading is added above paragraph 21A and the headings below paragraph 21 and above paragraph 22 are amended. New text is underlined and deleted text is struck through. Paragraph 10 is unamended but is included for ease of reference.

The acquisition method

...

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

10 **As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.**

Recognition conditions

11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the ~~*Framework for the Preparation and Presentation of Financial Statements**~~ *Conceptual Framework for Financial Reporting* at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other HKFRSs.

~~* For this Standard, acquirers are required to apply the definitions of an asset and a liability and supporting guidance in the *Framework for the Preparation and Presentation of Financial Statements* rather than the *Conceptual Framework for Financial Reporting* issued in 2018.~~

...

14 Paragraphs B31–B40 provide guidance on recognising intangible assets. Paragraphs ~~22~~21A–28B specify the types of identifiable assets and liabilities that include items for which this HKFRS provides limited exceptions to the recognition principle and conditions.

...

Exceptions to the recognition or measurement principles

21 This HKFRS provides limited exceptions to its recognition and measurement principles. Paragraphs ~~22~~21A–31A specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs ~~22~~21A–31A, which will result in some items being:

(a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other HKFRSs, with results that differ from applying the recognition principle and conditions.

(b) measured at an amount other than their acquisition-date fair values.

~~Exception~~ Exceptions to the recognition principle

Liabilities and contingent liabilities within the scope of HKAS 37 or HK(IFRIC)-Int 21

21A Paragraph 21B applies to liabilities and contingent liabilities that would be within the scope of HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or HK(IFRIC)-Int 21 *Levies* if they were incurred separately rather than assumed in a business combination.

21B The *Conceptual Framework for Financial Reporting* defines a liability as ‘a present obligation of the entity to transfer an economic resource as a result of past events’. For a provision or contingent liability that would be within the scope of HKAS 37, the acquirer shall apply paragraphs 15–22 of HKAS 37 to determine whether at the acquisition date a present obligation exists as a result of past events. For a levy that would be within the scope of HK(IFRIC)-Int 21, the acquirer shall apply HK(IFRIC)-Int 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.

21C A present obligation identified in accordance with paragraph 21B might meet the definition of a contingent liability set out in paragraph 22(b). If so, paragraph 23 applies to that contingent liability.

Contingent liabilities and contingent assets

22 HKAS 37 ~~*Provisions, Contingent Liabilities and Contingent Assets*~~ defines a contingent liability as:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

23 ~~The requirements in HKAS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the~~ The acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to paragraphs 14(b), 23, 27, 29 and 30 of HKAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Paragraph 56 of this HKFRS provides guidance on the subsequent accounting for contingent liabilities.

23A HKAS 37 defines a contingent asset as 'a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity'. The acquirer shall not recognise a contingent asset at the acquisition date.

...

Effective date and transition

Effective date

...

64Q *Reference to the Conceptual Framework*, issued in June 2020, amended paragraphs 11, 14, 21, 22 and 23 and added paragraphs 21A, 21B, 21C and 23A. An entity shall apply those amendments 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 January 2022. Earlier application is permitted if at the same time or earlier an entity also applies all the amendments made by *Amendments to References to the Conceptual Framework in HKFRS Standards*, issued in June 2018.

Basis for Conclusions on

Hong Kong Financial Reporting Standard 3 (Revised)

Business Combinations

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

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**
Scope exceptions for joint ventures	**BC434E**
Previously held interest in a joint operation (amendments issued in December 2017)	**BC434F**
BENEFITS AND COSTS	**BC435**
DISSENTING OPINIONS ON IFRS 3	

APPENDICES

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

B **Definition of a Business (Amendments to the Basis for Conclusions on IFRS 3 *Business Combinations*)**

C **Reference to the Conceptual Framework (Amendments to the Basis for Conclusions on IFRS 3 *Business Combinations*)**

Appendix C

Reference to the Conceptual Framework (Amendments to the Basis for Conclusions on IFRS 3 *Business Combinations*)

This appendix contains amendments to Basis for Conclusions on IFRS 3 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted.

Paragraphs BC114A–BC114B are amended and paragraphs BC114C–BC114D are added. Paragraph BC125 and the heading above it are deleted. Paragraphs BC264A-BE264E and a heading above paragraph BC264A are added. A heading below paragraph BC264 and a heading above paragraph BC265 are amended. The heading above paragraph BC276 is amended and paragraphs BC276A–BC276B are added. Paragraphs BC434G–BC434H are added and a heading is added above paragraph BC434G. New text is underlined and deleted text is struck through.

Applying the acquisition method

...

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition

...

Conditions for recognition

...

An asset or a liability at the acquisition date

...

BC114A Paragraph 11 of IFRS 3 ~~contains references~~ referred to the definitions of an asset and a liability in the *Framework for the Preparation and Presentation of Financial Statements* (*Framework*). It ~~requires~~ required those definitions to be used when deciding whether to recognise assets and liabilities as part of a business combination. In developing the revised *Conceptual Framework for Financial Reporting*, issued in 2018 (2018 *Conceptual Framework*), the IASB considered whether it should replace ~~those references~~ that reference with ~~references~~ a reference to the revised definitions in the 2018 *Conceptual Framework*. In some cases, applying the revised definitions could change which assets and liabilities qualify for recognition in a business combination. In some such cases, the post-acquisition accounting required by other IFRS Standards could then lead to immediate derecognition of assets or liabilities recognised in a business combination, resulting in so-called *Day 2 gains or losses* that do not depict an economic gain or loss.

BC114B Although the IASB intended to replace all references to the *Framework* with references to the 2018 *Conceptual Framework*, the IASB did not intend to make significant changes to the requirements of IFRS Standards containing those references. Consequently, the IASB decided to retain the reference to the *Framework* in paragraph 11 of IFRS 3 until it ~~completes~~ had completed an analysis of the possible consequences of referring in that paragraph to the revised definitions of an asset and a liability. ~~Once that analysis is complete, the IASB intends to amend IFRS 3 to replace the reference to the *Framework* in a way that avoids unintended consequences, such as *Day 2 gains or losses*.~~

BC114C The IASB's analysis led it to conclude that the problem of *Day 2 gains or losses* would be significant in practice only for liabilities that an acquirer accounts for after the acquisition date by applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies*. To avoid the problem, the IASB decided to add a further exception to the recognition principle in IFRS 3. The reasons for making this exception are explained in paragraphs BC264A–BC264E. The IASB noted that adding this exception to the recognition principle would not only avoid *Day 2 gains or losses*; it would also avoid any changes to the assets and liabilities recognised in a business combination ahead of any future amendments to align IAS 37 and IFRIC 21 with the 2018 *Conceptual Framework*.

BC114D The IASB replaced the reference to the *Framework* and added the exception to its recognition principle in May 2020. At the same time, the IASB made two other amendments to clarify aspects of IFRS 3 that it concluded would not be affected by replacing the reference to the *Framework*:

(a) the IASB added paragraph 23A to IFRS 3 to clarify the requirements for contingent assets—that is, possible assets whose existence is uncertain. IFRS 3 prohibits the recognition of contingent assets acquired in a business combination. This prohibition can be inferred from the recognition principle and is confirmed in paragraph BC276 of this Basis for Conclusions. However, the prohibition was not stated explicitly in IFRS 3 itself, and questions arose as to how it would be affected by replacing the reference to the *Framework*. The IASB concluded it would be unaffected—the 2018 *Conceptual Framework* specifies criteria for recognising assets and liabilities, and paragraph 5.14 says that these criteria might not be met if it is uncertain whether an asset exists. The IASB added paragraph 23A to IFRS 3 to make its requirements for contingent assets explicit and clarify that replacing the reference to the *Framework* does not change them.

(b) the IASB deleted paragraph BC125 from this Basis for Conclusions. In applying any IFRS Standard, an entity should apply only the recognition criteria specified in that Standard. However, paragraph BC125 referred to the *Framework* in a way that could be read to mean that, in applying IFRS 3, an acquirer of a business should apply both the recognition criteria specified in IFRS 3 and other recognition criteria discussed in the *Framework*. The IASB deleted paragraph BC125 because of its potential to cause misunderstanding. The IASB does not usually amend the basis for its previous conclusions, but decided that, in this instance, the importance of reducing the risk of misunderstanding warranted the deletion.

...

~~IFRS 3's criterion on reliability of measurement~~

BC125 [Deleted][*]

[*] See paragraph BC114D(b).

...

Exceptions to the recognition or measurement principle

...

~~Exception~~ Exceptions to the recognition principle

Liabilities and contingent liabilities within the scope of IAS 37 or IFRIC 21 (paragraphs 21A–21C)

BC264A Paragraph 11 of IFRS 3 specifies that, to qualify for recognition at the acquisition date, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the 2018 *Conceptual Framework*. Paragraph 54 of IFRS 3 specifies that after the acquisition date, an entity generally accounts for those assets and liabilities in accordance with other applicable IFRS Standards for those items.

BC264B As a result of applying the definition of a liability in the 2018 *Conceptual Framework*, an acquirer might recognise at the acquisition date a liability to pay a levy that it would not recognise subsequently when applying IFRIC 21 *Levies*. This difference arises because an entity might recognise a liability earlier applying the 2018 *Conceptual Framework*. Applying IFRIC 21, an entity recognises a liability to pay a levy only when it conducts the activity that triggers the payment of the levy, whereas applying the 2018 *Conceptual Framework*, an entity recognises a liability when it conducts an earlier activity if:

(a) conducting that earlier activity means the entity may have to pay a levy it would not otherwise have had to pay; and

(b) the entity has no practical ability to avoid the later activity that will trigger payment of the levy.

BC264C If an acquirer recognised a liability to pay a levy at the acquisition date when applying the 2018 *Conceptual Framework* and derecognised the liability immediately afterwards when applying IFRIC 21, it would recognise a so-called *Day 2 gain*. This recognised gain would not depict an economic gain, so would not faithfully represent any aspect of the entity's financial performance.

BC264D The IASB noted that IFRIC 21 is an interpretation of IAS 37, and so concluded that the problem of *Day 2 gains* could arise not only for levies within the scope of IFRIC 21 but also for other obligations within the scope of IAS 37. To avoid this problem, the IASB added paragraph 21B to IFRS 3. This paragraph makes an exception from the requirements of paragraph 11 for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 if incurred separately, rather than assumed in a business combination. The exception requires an entity to apply criteria in IAS 37 or IFRIC 21 respectively to determine whether a present obligation exists at the acquisition date. The exception refers to IFRIC 21 as well as IAS 37 because, although IFRIC 21 is an interpretation of IAS 37, it also applies to levies whose timing and amount are certain and so are outside the scope of IAS 37.

BC264E A present obligation identified applying the exception in paragraph 21B of IFRS 3 might meet the definition of a contingent liability. This will be the case if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or if the amount of the obligation cannot be measured with sufficient reliability. The IASB added paragraph 21C to IFRS 3 to clarify that, if the present obligation identified applying paragraph 21B meets the definition of a contingent liability, paragraph 23 of IFRS 3 also applies to that contingent liability.

Assets and liabilities arising from contingencies (paragraphs 22–23A)

...

The IASB's conclusions on contingent liabilities and contingent assets

...

BC276A In May 2020 the IASB added paragraph 23A to IFRS 3 to clarify the requirements for contingent assets. This amendment is explained further in paragraph BC114D(a).

BC276B The requirements for recognising contingent liabilities and contingent assets include both applications of and exceptions to the recognition principle. The IASB located all these requirements in the section headed 'exceptions to the recognition principle' because it concluded the requirements are clearest if they are all located together.

...

Effective date and transition

...

Amendments issued in May 2020

BC434G *Reference to the Conceptual Framework*, issued in May 2020, updated paragraph 11 of IFRS 3, replacing a reference to the *Framework* with a reference to the 2018 *Conceptual Framework*. It made further amendments to avoid unintended consequences of updating the reference.

BC434H Paragraph 64Q of IFRS 3 requires an entity to apply these amendments prospectively. It also permits an entity to apply the amendments before their effective date, without disclosing that it has done so. The IASB concluded that no significant benefits would be gained from requiring either retrospective application or disclosure of early application. The IASB reached this conclusion because it did not expect the amendments to change significantly the population of assets and liabilities recognised in a business combination.

HKAS 16
Revised ~~July 2019~~June 2020

Hong Kong Accounting Standard 16

Property, Plant and Equipment

Hong Kong Institute of
Certified Public Accountants
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B Amendments to other pronouncements

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BASIS FOR CONCLUSIONS

APPENDIX A
AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IAS 16 *PROPERTY, PLANT AND EQUIPMENT—PROCEEDS BEFORE INTENDED USE*

TABLE OF CONCORDANCE

DISSENTING OPINIONS

Hong Kong Accounting Standard 16 *Property, Plant and Equipment* (HKAS 16) is set out in paragraphs 1-83 and Appendix ~~B~~C. All the paragraphs have equal authority. HKAS 16 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Appendix C

Amendments to HKAS 16 *Property, Plant and Equipment—Proceeds before Intended Use*

The following sets out amendments required for this Standard resulting from the amendments to HKAS 16 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted.

Paragraphs 17 and 74 are amended; paragraphs 20A, 74A, 80D and 81N are added. The requirements formerly in paragraph 74(d) have not been amended but have been moved to paragraph 74A(a). Deleted text is struck through and new text is underlined.

Measurement at recognition

...

Elements of cost

...

17 Examples of directly attributable costs are:

...

(e) costs of testing whether the asset is functioning properly (ie assessing whether the technical and physical performance of the asset is such that it is capable of being used in the production or supply of goods or services, for rental to others, or for administrative purposes), after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

...

...

20A Items may be produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management (such as samples produced when testing whether the asset is functioning properly). An entity recognises the proceeds from selling any such items, and the cost of those items, in profit or loss in accordance with applicable Standards. The entity measures the cost of those items applying the measurement requirements of HKAS 2.

...

Disclosure

...

74 The financial statements shall also disclose:

...

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

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

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

74A If not presented separately in the statement of comprehensive income, the financial statements shall also disclose:

(a) the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss; and

(b) the amounts of proceeds and cost included in profit or loss in accordance with paragraph 20A that relate to items produced that are not an output of the entity's ordinary activities, and which line item(s) in the statement of comprehensive income include(s) such proceeds and cost.

Transitional provisions

...

80D *Property, Plant and Equipment—Proceeds before Intended Use*, issued in June 2020, amended paragraphs 17 and 74 and added paragraphs 20A and 74A. An entity shall apply those amendments retrospectively, but only to items of property, plant and equipment that are brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments. The entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of that earliest period presented.

Effective date

...

81N *Property, Plant and Equipment—Proceeds before Intended Use*, issued in June 2020, amended paragraphs 17 and 74, and added paragraphs 20A, 74A and 80D. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

ACCOUNTING FOR BEARER PLANTS (2014 AMENDMENTS)	**BC38**
Overview	**BC38**
Background	**BC39**
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APPENDIX A
AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IAS 16
PROPERTY, PLANT AND EQUIPMENT—PROCEEDS BEFORE INTENDED USE

TABLE OF CONCORDANCE

DISSENTING OPINIONS

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Appendix A

Amendments to the Basis for Conclusions on IAS 16 *Property, Plant and Equipment—Proceeds before Intended Use*

This appendix contains amendments to the Basis for Conclusions on IAS 16 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted.

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

After paragraph BC16, new headings and paragraphs BC16A–BC16R are added. After paragraph BC36A, a new heading and paragraphs BC36B–BC36D are added. New text is underlined.

Property, Plant and Equipment—Proceeds before Intended Use (2020 amendments)

Background

BC16A Before the 2020 amendments, paragraph 17(e) specified that directly attributable costs included the costs of testing whether an asset was functioning properly, after deducting the net proceeds from selling items produced while bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The Board received a request asking whether:

(a) the proceeds specified in paragraph 17(e) related only to items produced while testing; and

(b) an entity was required to deduct from the cost of an item of property, plant and equipment any such proceeds that exceeded the costs of testing.

BC16B The Board's research indicated that different entities had applied the requirements in paragraph 17(e) differently. Some entities deducted only proceeds from selling items produced while testing; others deducted the proceeds of all sales until an asset was in the location and condition necessary for it to be capable of operating in the manner intended by management (ie available for use). For some entities, the proceeds deducted from the cost of an item of property, plant and equipment could be significant and could exceed the costs of testing.

Recognising proceeds and related cost in profit or loss

BC16C After considering the findings in paragraph BC16B, the Board decided to amend paragraph 17 to prohibit an entity from deducting from the cost of an item of property, plant and equipment the proceeds from selling items produced before that asset is available for use (proceeds before intended use).

BC16D In the Board's view, the amendments will improve financial reporting. Proceeds before intended use and related cost meet the definition of income and expenses in the *Conceptual Framework for Financial Reporting*. Those items of income and expenses reflect an entity's performance for the period and they should, therefore, be included in the statement of profit or loss.

BC16E The previous requirement to offset proceeds against the cost of an item of property, plant and equipment reduced the usefulness of financial statements to users of financial statements. This is because the previous requirement resulted in an entity including amounts that did not faithfully represent:

(a) its performance. Offsetting proceeds against the cost of an asset understates an entity's revenue (or income) in the period. Moreover, doing so could also have a pervasive and long-term effect on an entity's performance when the asset has a long useful life. Offsetting proceeds decreased the depreciable amount of such an asset and, consequently, reduced the depreciation charge recognised as an expense over the asset's useful life.

(b) the cost of an item of property, plant and equipment. Offsetting proceeds could result in the carrying amount of the asset understating its cost. This, in turn, could reduce the usefulness of financial metrics, such as return on assets, that use the asset's carrying amount.

BC16F The Board considered suggestions that recognising proceeds before intended use and related cost in profit or loss might not provide useful information to users of financial statements. Those holding this view suggested that such sales proceeds—and the related margin—may have little predictive value because:

(a) the sales proceeds are generally non-recurring and are not necessarily an output of an entity's ordinary activities; and

(b) the cost of items produced would not include depreciation of the item of property, plant and equipment—because depreciation of that asset begins when it is available for use.

BC16G In the Board's view, however, the fact that the proceeds may have little predictive value was not a compelling argument for excluding them from profit or loss—the statement of profit or loss includes other items of income or expenses that may have little predictive value but the inclusion of which nonetheless provides useful information to users of financial statements. Recognising proceeds before intended use and related cost in profit or loss will result in entities reporting amounts that more faithfully represent their performance and financial position. It will also have confirmatory value about an entity's performance. The disclosure requirements in paragraph 74A(b) will highlight such proceeds and cost for users of financial statements (see paragraphs BC16L–BC16M).

Measuring the cost of items produced

BC16H When it exposed draft amendments for comment, the Board proposed no requirements on measuring the cost of items produced before an item of property, plant and equipment is available for use. A number of respondents to the Board's draft amendments suggested that the Board develop such requirements. They said measuring the cost of items produced could require extensive judgement, which in turn could result in differences in how entities measure that cost. Respondents' views differed on how prescriptive any requirements should be—some suggested the Board develop only high-level principles while others suggested providing detailed application guidance.

BC16I After considering this feedback, the Board decided to require an entity to apply IAS 2 *Inventories* in measuring the cost of items produced. The Board made this decision because:

(a) IAS 2 sets out a framework for measuring cost without being overly prescriptive; and

(b) an entity would already be required to apply IAS 2 in measuring cost if the entity were to determine that the sale of items produced is an output of its ordinary activities—in this case, the items produced would meet IAS 2's definition of inventories. It would be useful to apply the same requirements to the cost of items produced irrespective of whether the sale of those items is an output of an entity's ordinary activities.

BC16J In addition, the Board concluded that the judgement involved in measuring the cost of items produced is not substantially different from judgements already required when applying IAS 2 and other IFRS Standards in measuring cost, in particular for assets that take a substantial period of time to get ready for their intended use (for example, measuring the cost of abnormal amounts of wasted materials and labour, allocating costs to joint products or measuring the cost of operations incidental to the construction or development of an item of property, plant and equipment).

BC16K The Board acknowledged the amendments might result in implementation costs for some entities. However, the Board concluded that a requirement to measure the cost of items produced applying IAS 2 would not impose costs that outweigh the usefulness of the information provided.

Presentation and disclosure

BC16L The Board developed the requirements in paragraph 74A(b) to provide users of financial statements with information about the sale of items that are not an output of an entity's ordinary activities. Users of financial statements said information that enables them to identify proceeds before intended use, and to understand how those proceeds and related cost affect an entity's performance, would be useful.

BC16M The Board decided not to develop similar requirements for sales of items that are an output of an entity's ordinary activities because the requirements of IFRS 15 *Revenue from Contracts with Customers* and IAS 2 would apply to the proceeds from such sales and related cost.

BC16N Measuring the cost of items produced could necessitate the use of estimates and judgement. However, the Board decided not to add disclosure requirements in this respect because other IFRS Standards such as IAS 1 *Presentation of Financial Statements* already require the disclosure of information about estimates and judgements.

BC16O The Board also decided not to develop specific presentation requirements for proceeds before intended use and related cost because IAS 1 already includes relevant requirements, for example on:

(a) the offsetting of income and expenses; and

(b) the presentation of income and expenses as separate line items in the statement of profit or loss.

Available for use and the meaning of 'testing'

BC16P Paragraph 20 requires an entity to determine when an item of property, plant and equipment is available for use. The Board was informed of differences in how entities make that determination, and considered suggestions to clarify when an asset is available for use. Some of those making this suggestion said the existence of significant proceeds before intended use might indicate that an asset is already available for use before it is determined to be so. In their view, such a clarification would reduce the amount of proceeds being deducted from the cost of an asset than had previously been the case and, thus, would address the matter identified in paragraph BC16B without changing how those proceeds are recognised.

BC16Q The Board decided not to amend IAS 16 to clarify when an asset is available for use. Such an amendment would not be narrow in scope—it might affect the measurement of many items of property, plant and equipment, and additional research would be required to assess potential unintended consequences. Furthermore, the Board had obtained no evidence that differences in how entities determine when an asset is available for use could lead to material differences in the entities' financial statements.

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BC16R Nonetheless, the Board decided to clarify the meaning of 'testing' in paragraph 17, noting that such a clarification might help an entity in determining when an asset is available for use. The Board concluded that when testing whether an asset is functioning properly, an entity assesses the technical and physical performance of the asset. The assessment of functioning properly is not an assessment of the financial performance of an asset, such as assessing whether the asset has achieved the level of operating margin initially anticipated by management.

...

Property, Plant and Equipment—Proceeds before Intended Use (2020 amendments)

BC36B The 2020 amendments are expected mainly to affect only a few industries, such as mining and petrochemicals. The Board therefore considered the need, if any, for transition requirements beyond those in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC36C The Board concluded that the expected benefits of retrospectively applying the amendments in accordance with IAS 8 might be outweighed by the costs of doing so—in particular, an affected entity might find it difficult and costly to apply the amendments retrospectively to assets made available for use many years ago. In the Board's view, the transition requirements in paragraph 80D promote consistency in application of the amendments for all periods presented, but limit the number of assets an entity is required to reassess on first applying the amendments.

BC36D The Board decided not to provide transition requirements for first-time adopters of IFRS Standards because:

(a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides deemed cost exemptions for items of property, plant and equipment. These exemptions allow a first-time adopter to measure such assets without reference to IAS 16.

(b) if a first-time adopter does not apply those deemed cost exemptions, it would apply all the requirements in IAS 16 retrospectively. The Board concluded that there would be little benefit in providing first-time adopters with an exception or exemption relating to only one aspect of the requirements in IAS 16.

...

HKAS 37
Revised ~~July 2019~~June 2020

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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F. **Onerous Contracts – Cost of Fulfilling a Contract (Amendments to HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)**

G. **Addition of a Basis for Conclusions**

Hong Kong Accounting Standard 37 *Provisions, Contingent Liabilities and Contingent Assets* (HKAS 37) is set out in paragraphs 1-~~101~~102. All the paragraphs have equal authority. HKAS 37 should be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Appendix F

Onerous Contracts – Cost of Fulfilling a Contract (Amendments to HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets)*

The following sets out amendments required for this Standard resulting from amendments to HKAS 37 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted.

Paragraphs 68A, 94A and 105 are added and paragraph 69 is amended. Paragraph 68 is not amended, but is included for ease of reading. New text is underlined and deleted text is struck through.

Application of the recognition and measurement rules

...

Onerous contracts

...

68 This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

68A The cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract consist of both:

(a) the incremental costs of fulfilling that contract—for example, direct labour and materials; and

(b) an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others.

69 Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets ~~dedicated to that~~ used in fulfilling the contract (see HKAS 36).

...

Transitional provisions

...

94A *Onerous Contracts—Cost of Fulfilling a Contract*, issued in June 2020, added paragraph 68A and amended paragraph 69. An entity shall apply those amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments (the date of initial application). The entity shall not restate comparative information. Instead, the entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.

Effective date

...

105 *Onerous Contracts—Cost of Fulfilling a Contract*, issued in June 2020, added paragraphs 68A and 94A and amended paragraph 69. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

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Appendix G

Addition of a Basis for Conclusions

A Basis for Conclusions on IAS 37 containing paragraphs BC1–BC21 is added.

Onerous Contracts – Cost of Fulfilling a Contract (Amendments to HKAS 37) is based on *Onerous Contracts – Cost of Fulfilling a Contract* (Amendments to IAS 37). In approving amendments to HKAS 37, the Financial Reporting Standard Committee of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on amendments to IAS 37. Accordingly, there are no significant differences between the amendments to HKAS 37 and the amendments to IAS 37. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 37 referred to below generally correspond with those in HKAS 37.

Basis for Conclusions on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

This Basis for Conclusions accompanies, but is not part of, IAS 37. IAS 37 was issued by the International Accounting Standards Committee in 1998 and was not accompanied by a Basis for Conclusions. This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (Board) in developing amendments to IAS 37. Individual Board members gave greater weight to some factors than to others.

Onerous Contracts—Cost of Fulfilling a Contract (paragraph 68A)

BC1 In May 2020 the Board added paragraph 68A to IAS 37. Paragraph 68A specifies which costs an entity includes in determining the cost of fulfilling a contract for the purpose of assessing whether the contract is onerous. The Board added this clarification in response to a recommendation from the IFRS Interpretations Committee, whose research indicated that:

(a) differing views on which costs to include could lead to material differences in the financial statements of entities that enter into some types of contracts.

(b) the need for clarification was urgent. Following the withdrawal of IAS 11 *Construction Contracts*, entities are required to apply IAS 37 instead of IAS 11 to assess whether construction contracts are onerous. IAS 11 specified which costs to include, but IAS 37 did not.

The cost of fulfilling a contract

BC2 Views differed on what an entity should include in the cost of fulfilling a contract when assessing whether the contract is onerous—whether to include:

(a) only the incremental costs of fulfilling the contract—for example, the cost of materials and labour required to construct a building; or

(b) all costs that relate directly to the contract—both the incremental costs and an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract among others, or an allocation of the costs of management and supervision of contracts.

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BC3 The Board decided to require an entity to include all costs that relate directly to a contract. The Board concluded that:

(a) including all such costs provides more useful information to users of the entity's financial statements (paragraphs BC4–BC7);

(b) the benefits of providing that information are likely to outweigh the costs (paragraphs BC8–BC9); and

(c) a requirement to include all costs that relate directly to a contract is consistent with other requirements in IAS 37 and requirements in other IFRS Standards (paragraphs BC10–BC13).

Useful information

BC4 An entity may obtain the resources it needs to fulfil a contract in different ways. For example, if an entity needs equipment to fulfil a contract to manufacture goods or provide services, it may either hire the equipment for use only on that contract, or buy the equipment and use it on several contracts. The Board concluded that to provide a faithful representation of the effect of a contract on an entity's financial position, the entity should identify the resources needed to fulfil the contract and include the cost of those resources, regardless of how it expects to obtain them. Including only incremental costs in that assessment—for example, the costs of hiring equipment but not an allocation of the depreciation of purchased equipment—would fail to recognise the costs of resources shared with other contracts.

BC5 The Board considered contracts an entity will fulfil using existing assets with idle capacity. If the income from such a contract will exceed the incremental cost of fulfilling it, the contract will improve the entity's financial position and performance. But, unless the income will fully cover the cost of the capacity used, including that cost in assessing whether the contract is onerous might suggest otherwise because the entity will recognise an onerous contract provision and a loss when it incurs a present obligation by entering into the contract. If that capacity were not used to fulfil the contract, such a loss would not be recognised.

BC6 The Board concluded that, even for a contract that will be fulfilled using existing idle capacity, including all costs that relate directly to the contract (that is, including the cost of the capacity used) provides useful information. By entering into a contract at a price that does not fully cover the cost of the capacity used, the entity has committed itself to using that capacity to provide goods or services at a price that would not be sustainable if all contracts were similarly priced. The entity has effectively committed itself to making a loss on that capacity for the life of the contract. In the Board's view, including the cost of the capacity used in assessing whether a contract is onerous provides information that is relevant to users of financial statements and faithfully represents the effect of the contract on the entity's financial position and performance. The Board noted that an entity would disclose additional information about the contract if such information is relevant to an understanding of the entity's financial statements.

BC7 The Board also considered requirements in other IFRS Standards. Several IFRS Standards—such as IAS 2 *Inventories*—specify the costs to include in measuring a non-monetary asset. Although their detailed requirements differ, they all require an entity to include both the incremental costs of purchasing or constructing the asset, and an allocation of other directly related or directly attributable costs, such as production overheads. The Board concluded that, in assessing whether a contract to deliver goods is onerous, the way an entity determines the cost of fulfilling the contract should be broadly consistent with the way it measures the cost of the goods when it holds them. Such consistency leads to more useful information.

Cost of applying the requirements

BC8 The Board discussed suggestions that it might be costly for a manufacturing entity to estimate and allocate all the costs that relate directly to a contract if the entity has not yet manufactured the goods it will deliver under the contract.

BC9 The Board noted that IAS 2 requires an entity to measure the cost of manufactured inventories at an amount that includes both the incremental costs of production and an allocation of production overheads. Further, a manufacturing entity that enters into contracts to supply inventory is likely to need information about these costs to make pricing decisions. Therefore, the entity is likely to have already the information it needs to estimate and allocate the costs that will relate directly to contracts into which it has entered. The Board therefore concluded that a requirement to estimate and allocate costs that relate directly to a contract would not impose costs that outweigh the usefulness of the information provided.

Consistency with other requirements in IAS 37 and requirements in other IFRS Standards

BC10 IAS 37 defines an onerous contract as 'a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it'. The Board concluded that the unavoidable costs of fulfilling a contract are the costs an entity cannot avoid because it *has* the contract (as opposed to the costs the entity could avoid if it *did not have* the contract). The costs an entity cannot avoid because it has a contract include both the incremental costs of that contract and an allocation of other costs that relate directly to fulfilling contracts, including that contract.

BC11 The Board discussed whether including costs other than the incremental costs of fulfilling a contract would be inconsistent with other requirements in IAS 37. Those holding this view suggested that, because an entity will incur those other costs regardless of whether it fulfils the contract under consideration, the costs are not costs of 'fulfilling the contract'—they are costs of operating the business. Paragraph 18 of IAS 37 specifies that no provision is recognised for costs that need to be incurred to operate in the future, and paragraph 63 prohibits recognition of future operating losses.

BC12 However, the Board concluded that a requirement to include all costs that relate directly to a contract in assessing whether the contract is onerous is consistent with other requirements in IAS 37. It concluded that:

(a) in recognising an onerous contract provision, an entity would not be recognising a provision for the costs themselves—that is, it would not be identifying those costs as present obligations in their own right. Instead, the entity would be recognising its present obligation to deliver goods or provide services in exchange for other economic benefits, measuring that obligation at an amount that includes the cost of all the resources to be used to fulfil the obligation.

(b) paragraph 63 of IAS 37 prohibits an entity from recognising future operating losses because such losses are not liabilities; in other words, the entity does not have a present obligation to incur those losses. In contrast, in assessing whether a contract is onerous, an entity determines the cost of fulfilling its present obligation under an existing contract. Therefore, including all costs that relate directly to a contract in assessing whether the contract is onerous does not result in an entity recognising future operating losses.

BC13 The Board noted that a requirement to include all costs that relate directly to a contract is consistent with IFRS 17 *Insurance Contracts*. IFRS 17 requires insurers to include all costs that relate directly to the fulfilment of a contract in assessing whether an insurance contract is onerous. These costs include an allocation of fixed and variable overheads directly attributable to fulfilling insurance contracts.

Examples

BC14 When it exposed draft amendments for comment, the Board proposed to include a list of examples of costs that do and do not relate directly to a contract. These examples were based on paragraphs 97–98 of IFRS 15 *Revenue from Contracts with Customers*.

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BC15 Some respondents to the Board's draft amendments noted differences between the examples proposed and those in other IFRS Standards that specify which costs to include in measuring the cost of non-monetary assets. Those respondents asked the Board to clarify whether some costs mentioned in those other IFRS Standards would be regarded as costs that relate directly to the contract by an entity applying IAS 37. Respondents also asked the Board to provide examples of costs that relate directly to contracts other than contracts to deliver goods or provide services.

BC16 In response to this feedback, the Board decided to replace the list of examples with a more general description of the types of costs that relate directly to a contract—that is, the incremental costs of fulfilling the contract and an allocation of other costs that relate directly to fulfilling contracts. The Board concluded that the more general description:

(a) can be applied to all types of contract, rather than only to contracts to deliver goods or provide services;

(b) avoids unintended consequences of slight differences in the wording of examples in different IFRS Standards; and

(c) provides a framework within which an entity can judge whether a particular cost relates directly to a contract.

Interaction with requirements for impaired assets

BC17 Paragraph 69 of IAS 37 requires that, before an entity establishes a provision for an onerous contract, the entity recognises any impairment loss that has occurred on assets 'used in fulfilling the contract'. Paragraph 69 originally referred to assets 'dedicated to that contract'. However, the term 'dedicated' could be read to apply only to assets used solely on that contract, and not used on other contracts. The Board amended the terminology in paragraph 69 to clarify that the requirement to recognise any impairment loss before establishing an onerous contract provision applies to all assets whose cost would be considered in assessing whether the contract is onerous.

Scope

BC18 Some respondents to the Board's draft amendments asked the Board to expand the scope of the project to clarify other aspects of the onerous contract requirements in IAS 37, such as:

(a) measuring onerous contracts—whether an entity would consider the same costs in measuring a provision for an onerous contract as it would consider in assessing whether that contract is onerous.

(b) selecting a unit of account—whether, and if so when, an entity should combine groups of similar contracts or segment contracts into components when applying the onerous contract requirements.

BC19 The Board decided not to consider other aspects of the onerous contract requirements in IAS 37 because doing so would have prolonged the project, delaying the issue of amendments regarded as urgent (see paragraph BC1(b)). The amendments therefore do not change the requirements in IAS 37 beyond clarifying the costs an entity is required to include in assessing whether a contract is onerous.

Transitional provisions

BC20 On transition entities are required to apply the amendments only to contracts for which the entity has not fulfilled all its obligations at the date of initial application, without restating comparative amounts. The Board concluded that it may be difficult and costly for an entity to obtain the information needed to restate comparative amounts, and the information provided by doing so was unlikely to be sufficiently useful to justify the costs that the entity might incur.

BC21 The Board decided not to provide entities with an option to restate comparative amounts—that is, not to provide the option of retrospective application, as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Board concluded that the benefits of providing that option would be limited, and would be outweighed by the complexity and possible loss of comparability between the financial statements of entities applying the amendments at their effective date.