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

30 May 2008

To: Members of the Hong Kong Institute of CPAs
All other interested parties

EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING FRAMEWORK (SME-FRF) AND PROPOSED SECTIONS OF SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING STANDARD (SME-FRS)

- **SECTION 18 *BUSINESS COMBINATIONS AND GOODWILL***
- **SECTION 19 *CONSOLIDATED FINANCIAL STATEMENTS***
- **SECTION 20 *INVESTMENTS IN ASSOCIATES***
- **SECTION 21 *INTERESTS IN JOINT VENTURES***
- **SECTION 22 *CASH FLOW STATEMENTS***
- **PROPOSED AMENDMENTS TO OTHER SECTIONS OF SME-FRS**

Comments to be received by 30 September 2008

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the Exposure Draft which have been posted on the Institute's website at:
www.hkicpa.org.hk/professionaltechnical/accounting/exposuredraft/content.php.

Reasons for issuing this Exposure Draft

In August 2005, the Institute issued the SME-FRF and SME-FRS, which are effective for accounting periods beginning on or after 1 January 2005. Currently, the extant SME-FRS does not apply to the preparation and presentation of consolidated financial statements and does not require the presentation of a cash flow statement.

In March 2007 the Financial Services and the Treasury Bureau (FSTB) published a consultation paper on the Rewrite of the Accounting and Auditing Provisions of the Hong Kong Companies Ordinance (CO)[1] which sets out proposals to improve accounting and auditing provisions of the CO. The proposals are based on the work of the Joint Working Group[2] established in 2002 comprising representatives of the relevant government departments and the Institute.

(a) Consolidated financial statements (or group accounts)

In relation to the preparation and presentation of consolidated financial statements (described as "group accounts" in the consultation paper), paragraph 7.6(d) (page 42) of the consultation paper proposes that a private company which is the holding company of a small group of companies should be allowed to apply section 141D of the CO and prepare group accounts provided that certain "small group" size criteria are met.

Accordingly, the Institute notices that the proposal to extend the SME-FRF and SME-FRS to include group accounts is already under consideration by the CO-Rewrite team. In their consultation conclusions published on 26 March 2008, there is support indicating that SME-FRF and SME-FRS be amended to provide clear guidance on the preparation of group accounts.

[1] A copy of the consultation paper on the Rewrite of the Accounting and Auditing Provisions of the CO can be downloaded from http://fstb.gov.hk/fsb or http://www.cr.gov.hk.

[2] The full name of the Joint Working Group is Joint Government/Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the CO.

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The Institute is therefore considering making appropriate amendments to the SME-FRF in respect of the qualifying criteria for both Hong Kong and non-Hong Kong incorporated companies and the SME-FRS in respect of the preparation of group accounts.

For group accounts, the Institute proposes the following size criteria (paragraph 24 of the SME-FRF), which was also set out in the CO-Rewrite consultation paper.

A group of companies, whether the holding company is a Hong Kong incorporated company or a non-Hong Kong incorporated company, qualifies as a "small group" if it satisfies at least two out of the following conditions:

- *Aggregate total annual revenue*[3] *of not more than HK$50 million net for that year;*
- *Aggregate total assets*[4] *of not more than HK$50 million net at the balance sheet; and*
- *No more than 50 employees.*

The above conditions are subject to change as the CO-Rewrite progresses.

The Institute considers the introduction of group accounts provides an opportunity to bring in specific guidance on accounting for investments in associates and interests in joint ventures. The requirement to account for associates and jointly controlled entities using equity method in the investor's / venturer's consolidated financial statements proposed in this Exposure Draft better reflects the stewardship of management and enhances the transparency of the information in relation to associates or jointly controlled entities.

(b) Cash flow statement

The FRSC is of the view that cash flow statements are useful in providing users of financial statements with a basis for assessing the ability of the entity to generate cash and cash equivalents and enable users to develop models to assess and compare the present value of the future cash flows of different entities. When used in conjunction with other information in the financial statements, cash flow statements help users to evaluate the liquidity, viability and financial adaptability of an entity. Accordingly, the FRSC considers that a cash flow statement should be an integral part of the financial statements prepared under the SME-FRS.

A brief survey of SME framework in major jurisdictions reveals the following:

	Group accounts	Cash flow statements
UK	✔	Optional
Canada	Optional	✔
Singapore	✔	✔
IASB proposed IFRS for SMEs	✔	✔

3 In relation to the aggregate figures for total revenue, "net" means after making the set-offs and other adjustments in the case of group accounts for transactions between members of the group. The figures for aggregate total annual revenue shall be those included in the group accounts prepared under section 141D of the CO for the relevant financial year.

4 In relation to the aggregate figures for total assets, "net" means after making the set-offs and other adjustments in the case of group accounts for transactions between members of the group. The figures for aggregate total assets shall be those included in the group accounts prepared under section 141D of the CO for the relevant financial year.

The Way Forward

The proposed amendments have the following implications for Hong Kong incorporated companies and non-Hong Kong incorporated companies.

(a) Hong Kong incorporated companies:

Hong Kong incorporated companies applying the existing Section 141D of the CO will be required to prepare a cash flow statement as an integral part of the financial statements. Once the application of Section 141D of the CO is extended to small groups, Hong Kong incorporated holding companies would be able to prepare group accounts based on the SME-FRS.

(b) Non-Hong Kong incorporated companies

A cash flow statement would also form an integral part of the financial statements of a non-Hong Kong incorporated company and should be included as part of the financial statements prepared under the SME-FRS. Non-Hong Kong incorporated holding companies electing to prepare financial statements under SME-FRS would be required to prepare group accounts if they meet the size criteria as set out above.

The Institute will continue to monitor the developments of the CO Rewrite and may make further changes upon the finalisation of the CO Rewrite.

Once the Exposure Draft is approved, the illustrative financial statements prepared in accordance with the SME-FRS will be updated to provide an example of a complete set of consolidated financial statements, including a cash flow statement.

Matters under consultation

The Institute invites comments on any aspect of this Exposure Draft of proposed amendments to SME-FRF and proposed new / amended sections of SME-FRS. It particularly welcomes answers to the questions set out below. Comments are most helpful if they:

(a) answer the question as stated,
(b) indicate the specific paragraph or paragraphs to which they relate,
(c) contain a clear rationale, and
(d) describe any alternative the Institute should consider

Respondents need not comment on all of the questions. The Institute is not seeking comments on matters in the SME-FRF or SME-FRS not addressed in this Exposure Draft.

Question 1: Do you agree that the SME-FRF and SME-FRS should be amended to cover groups? If not, why not?

Question 2: Do you agree that the size criteria set out in paragraph 24 of the SME-FRF appropriately identify a "small group" in Hong Kong? If not, why not?

Question 3: **Do you agree that at the company level, investments in associates and interests in jointly controlled entities should be accounted for using the cost method? If not, why not? Do you agree that when an investor / a venturer presents consolidated financial statements, investments in associates and interests in jointly controlled entities should be accounted for using the equity method? If not, why not?**

Question 4: **Should a complete set of financial statements prepared under the SME-FRS be required to include a cash flow statement? If not, why not?**

Question 5: **If a cash flow statement is required, do you agree that either the direct method or indirect method can be used for reporting cash flows from operating activities, as set out in paragraph 22.7 of the SME-FRS? If not, why not?**

Question 6: **Are there any disclosure requirements included in sections 18 to 22 of the SME-FRS that you consider are too onerous for SMEs and therefore should be excluded? If so, what are they and why?**

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the Exposure Draft to be considered, they are requested to be received by the Institute on or before **30 September 2008**.

Comments may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

About the Exposure Draft

1. The SME-FRF is extended initially to cover non-Hong Kong incorporated companies which are holding companies of small groups. Upon the finalisation of amendments of section 141D of the CO, Hong Kong incorporated companies which are subsidiaries or holding companies of other companies eligible to apply section 141D of the CO qualify for reporting under the SME-FRF.

2. Section 1 of the SME-FRS proposes that a complete set of financial statements should include a cash flow statement. Section 22 provides guidance on the preparation of a cash flow statement.

3. Section 18 sets out the accounting for business combinations. It specifies that all business combinations other than those involving entities under common control should be accounted for by applying the purchase method. Therefore, the acquirer should measure the cost of a business combination as the aggregate of the fair values, at the acquisition date, of assets given, liabilities incurred or assumed, and equity instruments issued, in exchange for control of the acquiree, plus any costs directly attributable to the acquisition. The acquirer should also recognise the acquiree's identifiable assets and liabilities at their fair values at the acquisition date, and recognises goodwill.

4. Under section 18, after initial recognition, the acquirer should measure goodwill at cost less any accumulated amortisation and any accumulated impairment losses. There is a rebuttable presumption that the useful life of goodwill will not exceed 5 years. The acquirer should recognise immediately in profit or loss any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets and liabilities over cost after reassessment of the identification and measurement of the acquiree's identifiable assets and liabilities and the measurement of the cost of the combination.

5. In response to the introduction of Section 18, Section 9 is expanded to provide guidance on how to assess and measure impairment losses for goodwill. At each balance sheet, an entity should assess whether there is any indication that goodwill may be impaired. If there is an indication that goodwill has been impaired, the entity should follow a two-step process included in Section 9 to estimate the recoverable amount of goodwill which is derived from measurement of the recoverable amount of the larger group of assets of which the goodwill is a part, and determine whether to recognise an impairment loss.

6. Section 19 requires a parent to present consolidated financial statements unless it is a wholly-owned subsidiary of another entity or a partially-owned subsidiary of an entity with the consent of other members not to present consolidated financial statements. It provides guidance on how to prepare consolidated financial statements. Consolidation of a foreign subsidiary follows the same process set out in paragraphs 15.4 and 15.5.

7. Sections 20 and 21 specify the accounting for investments in associates and interests in joint ventures. An investor / a venturer will be required to account for its investments in associates and interests in jointly controlled entities using equity method only in the investor's / venturer's consolidated financial statements.

8. The objective of Section 22 is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

May 2008
Exposure Draft

Response Due Date
30 September 2008

Exposure Draft

Proposed Amendments to Small and Medium-sized Entity Financial Reporting Framework and Proposed Sections of Small and Medium-sized Entity Financial Reporting Standard

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

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The Exposure Draft can also be found on the Institute's website at:
www.hkicpa.org.hk/professionaltechnical/accounting/exposuredraft/content.php.

Amendments to Small and Medium-sized Entity Financial Reporting Framework

Paragraphs 17, 18, 19 and 24 are amended (new text is underlined and deleted text is struck through).

17. An entity, other than a company incorporated under the Companies Ordinance, subject to any specific requirements imposed by the law of the entity's place of incorporation and subject to its constitution, qualifies for reporting under the SME-FRF when the entity (including a group) does not have public accountability (paragraphs 22 – 23), and:

    (a) all of its owners or, in the case of a group, the owners of the parent entity agree to prepare the financial statements in accordance with the SME-FRS; and

    (b) the entity (including a group) is considered to be an SME in terms of its size under paragraph 24.

18. An entity which is a subsidiary or an intermediate holding company of an entity qualifies for reporting under the SME-FRF for its own and consolidated financial statements if it also satisfies the conditions set out in paragraph 17.

19. Unless the law requires otherwise, it is presumed that, once an agreement is made by all owners or, in the case of a group, all owners of the parent entity to prepare the financial statements in accordance with the SME-FRS, the agreement will remain valid until there is a change in the ownership or the agreement is revoked by an owner or an entity (including a group) no longer qualifies for reporting under the SME-FRF. Any reference in paragraphs 20-23 to 'an entity' is read as reference to 'a group'.

24. An entity is considered to be an SME or a group is qualified for reporting under the SME-FRF if it does not exceed any two of the following:

    (a) Aggregate ~~T~~total annual revenue of HK$50 million.

    (b) Aggregate ~~T~~total assets of HK$50 million at the balance sheet date.

    (c) 50 employees.

After paragraph 28, paragraph 28A is added.

28A. An entity should apply the amendments in paragraphs 17 to 19 and 24 for annual periods beginning on or after [Date]. Earlier application is permitted.

Section 18
Business Combinations and Goodwill

Scope

18.1 This Section should be applied in accounting for business combinations other than those involving entities under common control. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree.

18.2 A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Accounting

18.3 All business combinations other than those involving entities under common control should be accounted for by applying the purchase method.

18.4 Applying the purchase method involves the following steps:

(a) identifying an acquirer;

(b) measuring the cost of the business combination; and

(c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities assumed.

Identifying the acquirer

18.5 An acquirer should be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.

18.6 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. Control of one entity by another is described in Section 19 *Consolidated Financial Statements*.

18.7 Although sometimes it may be difficult to identify an acquirer, there are usually indications that one exists. For example:

(a) if the fair value of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer;

(b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer; and

(c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

Cost of a business combination

18.8 The acquirer should measure the cost of a business combination as the aggregate of:

(a) the fair values, at the acquisition date, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus

(b) any costs directly attributable to the business combination.

Adjustments to the cost of a business combination contingent on future events

18.9 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer should include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable (ie more likely than not) and can be measured reliably.

18.10 However, if the potential adjustment is not recognised at the acquisition date but subsequently becomes probable and can be measured reliably, the additional consideration should be treated as an adjustment to the cost of the combination.

Allocating the cost of a business combination to the assets acquired and liabilities assumed

18.11 The acquirer should, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets and liabilities that satisfy the recognition criteria under the SME-FRF and SME-FRS at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets and liabilities so recognised should be accounted for in accordance with paragraphs 18.15 to 18.20.

18.12 The acquirer should recognise separately the acquiree's identifiable assets and, liabilities at the acquisition date only if they satisfy the following criteria at that date:

(a) in the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;

(b) in the case of a liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably; and

(c) in the case of an intangible asset, its fair value is readily apparent or otherwise can be determined without undue cost or effort.

18.13 The acquirer's income statement should incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's income statement that relates to the acquiree's depreciable assets should be based on the fair values of those depreciable assets at the acquisition date, ie their cost to the acquirer.

18.14 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer effectively obtains control of the acquiree. All pertinent facts and circumstances surrounding a business combination should be considered in assessing when the acquirer has obtained control.

Goodwill

18.15 The acquirer should, at the acquisition date:

(a) recognise goodwill acquired in a business combination as an asset; and

(b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets and liabilities recognised in accordance with paragraph 18.11.

18.16 After initial recognition, the acquirer should measure goodwill acquired in a business combination at cost less any accumulated amortisation and any accumulated impairment losses.

18.17 Goodwill should be amortised on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of goodwill will not exceed 5 years from initial recognition. The amortisation method used should reflect the pattern in which the future economic benefits arising from goodwill are expected to be consumed. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense.

18.18 The amortisation period and the amortisation method should be reviewed at least at the end of each financial year if the useful life of goodwill exceeds 5 years. If the expected useful life of goodwill is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the goodwill, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for as changes in accounting estimates by adjusting the amortisation charge for the current and future periods.

18.19 To determine whether goodwill is impaired, an entity applies Section 9 *Impairment of Assets.* That Section explains when and how an entity reviews the carrying amount of its assets and how it determines the recoverable amount of an asset.

Excess of acquirer's interest in the net fair value of acquiree's identifiable assets and liabilities over cost ("Negative goodwill")

18.20 If the acquirer's interest in the net fair value of the identifiable assets and liabilities recognised in accordance with paragraph 18.11 exceeds the cost of the business combination, the acquirer should:

(a) reassess the identification and measurement of the acquiree's identifiable assets and liabilities and the measurement of the cost of the combination; and

(b) recognise immediately in profit or loss any excess remaining after that reassessment.

<u>Business combinations achieved in stages</u>

18.21 A business combination in which an acquirer holds a non-controlling equity investment in the acquiree immediately before obtaining control of that acquiree is a business combination achieved in stages.

18.22 For the purposes of applying the acquisition method under this Section, the acquirer should remeasure its equity interest previously held in the acquiree at the fair value of the proportionate share of the assets and liabilities of the acquiree at the acquisition date and recognise the difference between the fair value of the proportionate share of the assets and liabilities and the previous carrying amount of that equity interest in the acquiree, if any, in a separate component of equity. The cost of the business combination at the acquisition date calculated in accordance with paragraph 18.8(a) is the aggregate of the acquirer's proportionate share of the fair value of the assets and liabilities held in the acquiree immediately before the acquisition date and the fair value of consideration transferred in exchange for additional equity interest in the acquiree. On the disposal of the subsidiary, the revaluation difference included in equity relating to that subsidiary should be recognised in profit or loss when the gain or loss on disposal is recognised. An illustrative example is set out in Appendix 3.

18.23 Once an acquirer has obtained control of an acquiree, subsequent acquisitions of any interests in the acquiree (or disposals, where the acquirer retains control) should be accounted for as equity transactions with the minority interests based on the proportionate interest in the net carrying amount of the minority interest in the acquiree in the consolidated financial statements of the acquirer at the time of the transaction. An illustrative example is set out in Appendix 3.

Disclosure

For business combination(s) effected during the period

18.24 For each business combination that was effected during the period (or group of individually immaterial business combinations), the acquirer should disclose the following:

(a) the names and descriptions of the combining entities or businesses;

(b) the acquisition date;

(c) the percentage of voting equity instruments acquired;

(d) the nature of control if the acquirer does not own, directly or indirectly through subsidiaries, more than one half of the voting power of the acquiree;

(e) the cost of the combination and a description of the components of that cost, including any costs directly attributable to the combination. When equity instruments are issued or issuable as part of the cost, the following should also be disclosed:

(i) the number of equity instruments issued or issuable; and

(ii) the fair value of those instruments and the basis for determining that fair value.

When there is a potential adjustment to the cost of the business that is contingent on future events and is not recognised at the acquisition date, this contingency should be disclosed in accordance with Section 10, *Provisions, Contingent Liabilities and Contingent Assets*;

(f) the amount of any excess recognised in profit or loss in accordance with paragraph 18.20, and the line item in the income statement in which the excess is recognised; and

(g) the amount of the acquiree's profit or loss since the acquisition date included in the acquirer's consolidated profit or loss for the period.

For business combination(s) effected after the end of the reporting period but before the financial statements are authorised for issue

18.25 For each business combination effected after the end of the reporting period but before the financial statements are authorised for issue, the acquirer should disclose it as a non-adjusting event in accordance with Section 17 *Events After the Balance Sheet Date* if the business combination is of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

For goodwill

18.26 For goodwill, an acquirer should disclose the following, where applicable:

(a) the accounting policy adopted;

(b) the amortisation period(s) adopted;

(c) if goodwill is amortised over more than 5 years, the reasons why the presumption that the useful life of goodwill will not exceed 5 years from initial recognition is rebutted;

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

(e) the line item(s) of the income statement in which the amortisation of goodwill is included; and

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

(i) additions arising from new business combinations;

(ii) changes arising from disposals of previously acquired businesses;

(iii) impairment losses recognised in the income statement during the period;

(iv) amortisation or write-off recognised during the period; and

(v) other changes in the carrying amount during the period.

Comparative information is not required.

Transitional provisions and effective date

18.27 This Section should apply to the accounting for business combinations for which the acquisition date falls within annual periods beginning on or after [date to be inserted]. This Section should also apply to the accounting for:

(a) goodwill arising from a business combination for which the acquisition date falls within annual periods beginning on or after [date to be inserted]; or

(b) any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets and liabilities over the cost of a business combination for which the acquisition date falls within annual periods beginning on or after [date to be inserted].

Previous business combinations

18.28 An entity that has not previously issued consolidated financial statements should apply this Section either:

(a) retrospectively to all past business combinations as a change in accounting policy in accordance with Section 2 *Accounting Policies, Change in Accounting Estimates and Errors*; or

(b) as if all the past business combinations that occurred before the beginning of the comparative period had taken place at the beginning of the comparative period. The difference between the consideration transferred and the carrying amounts of assets and liabilities of the business acquired that meet the recognition criteria under the SME-FRF and SME-FRS at the beginning of the comparative period should be made against the opening balance of retained earnings. Any business combination for which the acquisition date falls between the beginning of the comparative period and the date of the first application of this Section should be accounted for in accordance with this Section. In the case where this option is used, this fact should be disclosed.

In each case, the assets and liabilities of the business acquired should be remeasured using SME-FRS for consolidation purpose.

18.29 An entity that has previously issued consolidated financial statements for annual periods before [date to be inserted] should treat the previous business combinations either:

(a) retrospectively to all past business combinations as a change in accounting policy in accordance with Section 2 *Accounting Policies, Change in Accounting Estimates and Errors*; or

(b) prospectively, except for derecognition of items (for example, deferred tax liability) which do not meet the recognition criteria under the SME-FRF and SME-FRS, with a corresponding adjustment to the opening balance of goodwill of the current period. If there is no goodwill carried in the balance sheet, the adjustment should be made against the opening balance of retained earnings of the current period. Any item included in the previously issued consolidated financial statements that meets the recognition criteria under the SME-FRF and SME-FRS but were previously measured on a basis inconsistent with the SME-FRF and SME-FRS need not be restated in accordance with the relevant section of the SME-FRS. However, an entity should disclose the fact that the comparatives are prepared in a different measurement basis and are not entirely comparable. Any goodwill or negative goodwill that is carried in the balance sheet at the beginning of the current period should be accounted for in accordance with paragraphs 18.30 and 18.31, where applicable.

Previously recognised goodwill

18.30 An entity should apply this Section prospectively, from the beginning of the first annual period beginning on or after [date to be inserted], to goodwill acquired in a business combination for which the acquisition date was before [date to be inserted]. Therefore, an entity should make a choice at the beginning of the first annual period beginning on or after [date to be inserted] either:

(a) write off the previously recognised goodwill against the opening balance of retained earnings; or

(b) treat the carrying amount of the previously recognised goodwill as at the beginning of the period in which this Section is first applied as its deemed cost for subsequent account under this Section. Amortisation on the deemed cost (including the rebuttable presumption of 5 years) commences from the time at which this Section is first applied. However, in the case where this option is used, this fact should be disclosed.

Previously recognised negative goodwill

18.31 The carrying amount of negative goodwill at the beginning of the first annual period beginning on or after [date to be inserted] that arose from a business combination for which the acquisition date was before [date to be inserted] should be derecognised at the beginning of that period, with a corresponding adjustment to the opening balance of retained earnings.

Appendix 3
Business combination achieved in stages

This appendix is illustrative only and does not form part of the SME-FRS.

The following example illustrates the application of the guidance on business combinations achieved in stages in paragraphs 18.21 – 18.23 of Section 18 *Business Combinations and Goodwill*. In particular, it deals with successive share purchases that result in:

i. an investee becoming a subsidiary; and
ii. an increase in ownership interest after control is obtained

i. <u>An investee becomes a subsidiary</u>

Entity A acquires a 20 per cent ownership interest in Entity B (a service company) on 1 January 20X1 for HK$800,000. On 1 January 20X2, Entity A acquires a further 60 per cent ownership interest in Entity B for HK$3,200,000 cash, thereby obtaining control.

Before obtaining control, Entity A does not have significant influence over Entity B and accounts for its initial 20 per cent investment as a long term investment in accordance with Section 6 *Investments.* Entity A's initial 20 per cent investment in Entity B is measured at HK$800,000 as at 31 December 20X1, assuming that there is no impairment loss on the investment.

The following shows Entity B's balance sheet as at 31 December 20X1 together with the fair values of the identifiable net assets:

	Carrying Amounts HK$	**Fair Values HK$**
Cash and receivables	500,000	500,000
Land	2,000,000	4,000,000
	2,500,000	4,500,000
Issued equity	100,000	
Retaining earnings	2,400,000	
	2,500,000	

Accounting for the business combination

Paragraph 18.22 of Section 18 states that the acquirer should remeasure its equity interest previously held in the acquiree at the fair value of the proportionate share of the assets and liabilities of the acquiree at the acquisition date and recognise the difference between the fair value of the proportionate share of the assets and liabilities and the previous carrying amount of that equity interest in the acquiree, if any, in a separate component of equity. The cost of the business combination at the acquisition date is the aggregate of the acquirer's proportionate share of the fair value of the assets and liabilities held in the acquiree immediately before the acquisition date and the fair value of consideration transferred in exchange for additional equity interest in the acquiree.

The amount of revaluation difference recognised in equity in the consolidated financial statements:

	HK$
Fair value of the identified net assets attributable to the 20% equity interest held immediately before acquisition (20% x HK$4,500,000)	900,000
Less:	
Carrying amounts of the 20% equity interest	(800,000)
	100,000

The amount of goodwill recognised in the consolidated financial statements:

	HK$
Cost of the combination:	
Fair value of the identified net assets attributable to the 20% equity interest immediately before acquisition (20% x HK$4,500,000)	900,000
Consideration paid for the 60% further ownership interest	3,200,000
	4,100,000
Less:	
Proportionate interest in the fair value of identifiable net assets of Entity B (80% x HK$4,500,000)	(3,600,000)
	500,000

The following shows Entity A's consolidation worksheet (all amounts in HK$'000) immediately after the acquisition of the additional 60 per cent ownership interest in Entity B, together with consolidation adjustments and associated explanations:

	Entity A	**Entity B**	**Consolidation Adjustments Dr**		**Consolidation Adjustments Cr**		**Consolidated**	
Net Assets								
Cash and receivables	1,000	500					1,500	
Investment in Entity B	4,000		100	(1)	4,100	(2)	-	
Land	-	2,000	2,000	(2)			4,000	Note (a)
Goodwill	-	-	500	(2)			500	Note (b)
	5,000	2,500					6,000	
Issued equity	1,000	100	100	(2)			1,000	Note (c)
Capital reserve arising from business combination achieved in stages	-	-			100	(1)	100	Note (d)
Retained earnings	4,000	2,400	2,400	(2)			4,000	Note (e)
Minority interest	-	-			900	(2)	900	Note (a)
	5,000	2,500					6,000	

Consolidation Adjustments

		Dr	Cr
(1)	Investment in Entity B	100	
	Equity – Capital reserve		100
	To restate the initial 20 per cent investment in Entity B to fair value		
(2)	Land	2,000	
	Issued equity	100	
	Goodwill	500	
	Retained earnings	2,400	
	Minority interest		900
	Investment in Entity B		4,100
	To uplift the carrying value of land to its fair value at the date of acquisition, recognise goodwill on the 80 per cent investment in Entity B, record the elimination of investor's investment in Entity B and recognise the minority interest in the Entity B		

Notes

The above consolidation adjustments result in:

(a) Entity B's identifiable net assets being stated at their full fair values at the date Entity A obtains control of Entity B. This means that the 20 per cent minority interest in Entity B also is stated at the minority's 20 per cent share of the fair values of Entity B's identifiable net assets.

(b) goodwill being recognised from the acquisition date at an amount based on the calculation required by paragraph 18.15.

(c) issued equity of HK$1,000,000 representing the issued equity of Entity A of HK$1,000,000.

(d) capital reserve arising from business combination achieved in stages recognised in equity at an amount based on the calculation required by paragraph 18.22.

(e) a retained earnings balance HK$4,000,000 representing the retaining earnings of Entity A of HK$4,000,000.

ii. <u>Increase in ownership interest after control is obtained</u>

On 31 December 20X2 Entity A increased its interest in Entity B to 85 per cent by purchasing shares in Entity B from a minority interest for cash of HK$300,000. Immediately before this transaction, the carrying amount in Entity A's consolidated financial statements of the minority interest in Entity B was HK$920,000.

Entity A accounts for the acquisition in its consolidated financial statements as follows:

	HK$	HK$
Dr Minority Interest (5%/20%) x 920,000	230,000	
Dr Equity	70,000	
Cr Cash		300,000

To recognise the additional 5 per cent investment acquired in Entity B.

The excess recognised as an adjustment to the consolidated equity attributable to the equity holders of the parent reflects the premium paid by the parent entity in excess of the carrying amount of the 5 per cent ownership interest acquired.

Section 19
Consolidated Financial Statements

19.1 Except as permitted by paragraph 19.2, a parent should present consolidated financial statements in which it consolidates its investments in subsidiaries in accordance with SME-FRS. Consolidated financial statements should include all subsidiaries of the parent.

19.2 A parent need not present consolidated financial statements if:

(a) it is a wholly-owned subsidiary of another entity; or

(b) it is a partially-owned subsidiary of another entity and has the consent of all its other members for not presenting consolidated financial statements.

Control

19.3 A subsidiary is an entity that is controlled by the parent.

19.4 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity but it has:

(a) power over more than half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the entity under a statute or an agreement;

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

Consolidation procedures

19.5 The consolidated financial statements present financial information about the group as a single economic entity. In preparing consolidated financial statements, an entity should:

(a) combine the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses;

(b) eliminate the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of equity of each subsidiary at acquisition date;

(c) measure minority interests in the profit or loss of consolidated subsidiaries for the reporting period separately from the parent shareholders’ interest; and

(d) measure minority interests in the net assets of consolidated subsidiaries separately from the parent shareholders’ equity in them. Minority interests in the net assets consist of:

(i) the amount of those minority interests at the date of the original combination; and

(ii) the minority’s share of changes in equity since the date of the combination.

Intragroup balances and transactions

19.6 Intragroup balances and transactions, including accounts payable and receivable, income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements.

Uniform reporting date

19.7 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements should be prepared as of the same reporting date unless it is impracticable to do so.

19.8 When, in accordance with paragraph 19.9, the financial statements of a subsidiary used in the preparation of consolidated financial statements are prepared as of a reporting date different from that of the parent, adjustments should be made for the effects of significant transactions or events that occur between that date and the date of the parent's financial statements. The length of the reporting periods and any difference in the reporting dates should be the same from period to period.

Uniform accounting policies

19.9 Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events and conditions in similar circumstances. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Acquisition and disposal of subsidiaries

19.10 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date until the date on which the parent ceases to control the subsidiary. The difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the subsidiary recognised in equity in accordance with Section 15 *The Effects of Changes in Foreign Exchange Rates*, is recognised in the consolidated income statement as the gain or loss on the disposal of the subsidiary.

19.11 If an entity ceases to be a subsidiary but the investor (former parent) continues to hold some equity shares, those shares should be accounted for as an investment in accordance with Section 6 *Investments* from the date the entity ceases to be a subsidiary, provided that it does not become an associate (in which case Section 20 *Investments in Associates* applies) or a jointly controlled entity (in which case Section 21 *Interests in Joint Ventures* applies). The carrying amount of the investment at the date that the entity ceases to be a subsidiary should be regarded as the cost on initial measurement of an investment.

Minority interests in subsidiaries

19.12 An entity should present minority interest in the consolidated balance sheet within equity, separately from the parent shareholders' equity.

19.13 An entity should disclose minority interest in the profit or loss of the group separately in the income statement.

19.14 Losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the subsidiary's equity. The excess, and any further losses applicable to the minority, are allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the subsidiary subsequently reports profits, such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Disclosure

19.15 An entity should disclose:

(a) the fact that the exemption from consolidation has been used if an entity elects in accordance with paragraph 19.2 not to present consolidated financial statements;

(b) the nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;

(c) the reasons why the ownership, directly or indirectly through subsidiaries, of more than half of the voting power of an investee does not constitute control; and

(d) a list of significant investments in subsidiaries, including the name, the principal place of operation and place of incorporation, an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held.

Effective date

19.16 An entity should apply this Section for annual periods beginning on or after [date to be inserted]. Earlier adoption is permitted. If an entity applies this Section for financial statements covering periods beginning before [date to be inserted], the entity should:

(a) disclose that fact; and

(b) adopt Section 18 *Business Combinations and Goodwill*, Section 20 *Investments in Associates* and Section 21 *Interests in Joint Ventures* at the same time.

Section 20
Investments in Associates

20.1 This Section should be applied in accounting for investments in associates. An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

Significant influence

20.2 (a) If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.

(b) Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

(c) A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

Initial recognition and subsequent measurement

20.3 An investor should account for its investments in all associates using the cost model in accordance with Section 6 *Investments*, except when an investor presents consolidated financial statements under Section 19 *Consolidated Financial Statements*, in which case, the investor should account for its investments in associates in the consolidated financial statements using the equity method set out in paragraph 20.4.

Equity method

20.4 Under the equity method, the investment is initially recorded at cost and the carrying amount is increased or decreased to recognise the investor's share of the profits or losses of the investee after the date of acquisition. The investor's share of the profit or loss of the investee is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for alterations in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the income statement. Such changes include those arising from foreign exchange translation differences and from the adjustment of differences in accordance with paragraph 20.6.

Application of the equity method

20.5 Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in Section 19 *Consolidated Financial Statements.* Furthermore, the broad concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate.

20.6 An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference (whether positive or negative) between the cost of the investment and the investor's share of the net fair values of the associate's identifiable assets and liabilities is treated as goodwill or negative goodwill as appropriate. Goodwill and negative goodwill should be accounted for in accordance with paragraphs 18.15 to 18.20*.* Goodwill relating to an associate is included in the carrying amount of the investment unless fully amortised or impaired. Appropriate adjustments to the investor's share of the profits or losses after acquisition reported by the associate are made to account for:

(a) depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are made for impairment losses recognised by the associate, such as property, plant and equipment; and

(b) amortisation of goodwill.

Any excess of the investor's share of the net fair value of the associate's identifiable assets and liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.

20.7 The most recent available financial statements of the associate are used by the investor in applying the equity method. When the reporting dates of the investor and the associate are different, the associate prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor unless it is impracticable to do so.

20.8 When, in accordance with 20.7, the financial statements of an associate used in applying the equity method are prepared as of a different reporting date from that of the investor, adjustments should be made for the effects of significant transactions or events that occur between that date and the date of the investor's financial statements. The length of the reporting periods and any difference in the reporting dates should be the same from period to period.

20.9 The investor's financial statements should be prepared using uniform accounting policies for like transactions and events in similar circumstances.

20.10 If an associate uses accounting policies other than those of the investor for like transactions and events in similar circumstances, adjustments should be made to conform the associate's accounting policies to those of the investor when the associate's financial statements are used by the investor in applying the equity method.

20.11 If an investor's share of losses of an associate equals or exceeds its interest in the associate, the investor discontinues recognising its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate. Such items may include preference shares and long-term receivables or loans but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Losses recognised under the equity method in excess of the investor's investment in ordinary shares are applied to the other components of the investor's interest in an associate in the reverse order of their seniority (ie priority in liquidation).

20.12 After the investor's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

20.13 An investor should discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and should account for the investment in accordance with Section 6 *Investments* from that date, provided the associate does not become a subsidiary or a joint venture as defined in Section 21 *Interests in Joint Ventures*.

20.14 The carrying amount of the investment at the date that it ceases to be an associate should be regarded as its cost on initial measurement as an investment in accordance with Section 6 *Investments*.

Transactions with associates

20.15 Where an associate is accounted for using the equity method, profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (including its consolidated subsidiaries) and an associate are recognised in the investor's financial statements only to the extent of unrelated investors' interests in the associate. 'Upstream' transactions are, for example, sales of assets from an associate to the investor. 'Downstream' transactions are, for example, sales of assets from the investor to an associate. The investor's share in the associate's profits and losses resulting from these transactions is eliminated.

Disclosures

20.16 An investor in an associate should disclose:

(a) the accounting policy for investments in associates;

(b) a list of significant investments in associates, including the name, the principal place of operation and place of incorporation, an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held;

(c) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances; and

(d) the fact together with an explanation that an associate is not accounted for using the equity method when an investor presents consolidated financial statements.

20.17 For investments in associates accounted for by the equity method, an investor should disclose separately its share of the profit or loss of such associates and the carrying amount of those investments.

Transitional provisions and effective date

20.18 An entity should apply this Section for annual periods beginning on or after [date to be inserted]. Earlier adoption is permitted. If an entity applies this Section for financial statements covering periods beginning before [date to be inserted], the entity should:

(a) disclose that fact; and

(b) adopt Section 18 *Business Combinations and Goodwill,* Section 19 *Consolidated Financial Statements* and Section 21 *Interests in Joint Ventures* at the same time.

20.19 The transitional provisions set out in Section 18 *Business Combinations and Goodwill* should also apply to the accounting for acquisition of associates.

Section 21
Interests in Joint Ventures

21.1 This Section should be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.

Forms of joint venture

21.2 Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.

Jointly controlled operations

21.3 The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale of the joint product and any expenses incurred in common are shared among the venturers.

21.4 In respect of its interests in jointly controlled operations, a venturer should recognise in its financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

Jointly controlled assets

21.5 Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.

21.6 In respect of its interest in a jointly controlled asset, a venturer should recognise in its financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities that it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses that it has incurred in respect of its interest in the joint venture.

Jointly controlled entities

21.7 A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

Initial recognition and subsequent measurement

21.8 A venturer should account for its interest in all jointly controlled entities using the cost model in accordance with Section 6 *Investments*, except when a venturer presents consolidated financial statements under Section 19 *Consolidated Financial Statements*, in which case, the venturer should account for its interests in jointly controlled entities in the consolidated financial statements using the equity method set out in paragraph 21.9.

Equity method

21.9 A venturer should measure its investments in jointly controlled entities by the equity method using the procedures in paragraphs 20.4 – 20.15 of Section 20 *Investments in Associates.*

Transactions between a venturer and a joint venture

21.10 When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer should recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer should recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

21.11 When a venturer purchases assets from a joint venture, the venturer should not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer should recognise its share of the losses resulting from these transactions in the same way as profits except that losses should be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.

If investor does not have joint control

21.12 An investor in a joint venture that does not have joint control should account for that investment in accordance with Section 6 *Investments* or, if it has significant influence in the joint venture, in accordance with Section 20 *Investments in Associates.*

Disclosures

21.13 A venturer should disclose:

(a) the accounting policy for each type of interests in joint ventures;

(b) a listing and description of interests in significant joint ventures. In respect of its interests in jointly controlled entities, the listing includes the name, the principal place of operation and place of incorporation, an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held; and

(c) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of joint ventures to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances.

21.14 For investments in jointly controlled entities accounted for by the equity method, an investor should disclose separately its share of the profit or loss of such jointly controlled entities and the carrying amount of those investments.

Transitional provisions and effective date

21.15 An entity should apply this Section for annual periods beginning on or after [date to be inserted]. Earlier adoption is permitted. If an entity applies this Section for financial statements covering periods beginning before [date to be inserted], the entity should:

(a) disclose that fact; and

(b) adopt Section 18 *Business Combinations and Goodwill*, Section 19 *Consolidated Financial Statements* and Section 20 *Investments in Associates* at the same time.

21.16 The transitional provisions set out in Section 18 *Business Combinations and Goodwill* should also apply to the accounting for acquisition of jointly controlled entities.

Section 22
Cash Flow Statement

22.1 The cash flow statement provides information about the historical changes in cash and cash equivalents of an entity, showing separately changes during the period from operating, investing and financing activities.

22.2 Cash equivalents are held to meet short-term cash commitments rather than for investment or other purposes. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

Presentation of a cash flow statement

22.3 An entity should present a cash flow statement that reports cash flows for a period classified by operating activities, investing activities and financing activities. Cash flows that are not investing or financing are classified as cash flows from operating activities.

Operating activities

22.4 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events and conditions that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash payments or refunds of income taxes, unless they can be specifically identified with financing and investing activities; and

(f) cash receipts and payments from investments, loans, and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in the determination of profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

Investing activities

22.5 Cash flows arising from investing activities represent expenditures made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets (including capitalised development costs), and other long-term assets;

(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments classified as cash equivalents or held for dealing or trading);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading);

(e) cash advances and loans made to other parties; and

(f) cash receipts from the repayment of advances and loans made to other parties.

Financing activities

22.6 Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash payments to owners to acquire or redeem the entity's shares;

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;

(d) cash repayments of amounts borrowed; and

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities

22.7 An entity should report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

22.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, unrealised foreign currency gains and losses, undistributed profits of associates, and minority interests; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivables and payables.

22.9 The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the income statement for:

(i) changes during the period in inventories and operating receivables and payables;

(ii) other non-cash items; and

(iii) other items for which the cash effects are investing or financing cash flows.

Reporting cash flows from investing and financing activities

22.10 An entity should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.

22.11 An entity shall disclose, in aggregate, in respect of both acquisitions and disposals of subsidiaries or other business units during the period each of the following:

(a) the total purchase or disposal consideration;

(b) the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents; and

(c) the amount of cash and cash equivalents in the subsidiary or business unit acquired or disposed of.

Foreign currency cash flows

22.12 An entity should record cash flows arising from transactions in a foreign currency in the entity's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.

22.13 The entity should translate cash flows of a foreign subsidiary/branch at the exchange rates between the reporting currency and the foreign currency at the dates of the cash flows.

22.14 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be reported in the cash flow statement. Therefore, the entity should remeasure cash and cash equivalents held during the period at period-end exchange rates. The entity should present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

Interest and dividends

22.15 An entity should disclose separately cash flows from interest and dividends received and paid (interest paid includes amount capitalised under the accounting policy choice in Section 13 *Borrowing Costs*). The entity should classify cash flows consistently from period to period as operating, investing or financing activities.

22.16 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

22.17 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Taxes on income

22.18 An entity should disclose separately cash flows arising from taxes on income and should classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity should disclose the total amount of taxes paid.

Non-cash transactions

22.19 An entity should exclude from the cash flow statement investing and financing transactions that do not require the use of cash or cash equivalents. An entity should disclose such transactions elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

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

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

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

(c) the conversion of debt to equity.

Components of cash and cash equivalents

22.21 An entity should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts reported in the cash flow statement to the equivalent items reported in the balance sheet.

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

Other disclosure

22.23 An entity should disclose the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

Amendments to
Other Sections of Small and Medium-sized Entity Financial Reporting Standard

Amendments to
Definitions

The definition of acquisition date is added after the definition of accounting policies.

Acquisition date is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer.

The definitions of business and business combination are added after the definition of borrowing costs.

A ***business*** is an integrated set of activities and assets conducted and managed for the purpose of providing:

(a) a return to investors; or

(b) lower costs or other economic benefits directly and proportionately to policyholders or participants.

A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set should be presumed to be a business.

A ***business combination*** is the bringing together of separate entities or businesses into one reporting entity.

The definition of a component of an entity is added after the definition of the closing rate.

A ***component of an entity*** is operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

The definition of financing activities is added after the definition of a finance lease.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

The definition of foreign operation is added after the definition of a foreign currency.

Foreign operation is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

The definition of a group is added after the definition of grants related to income.

A ***group*** is a parent and all its subsidiaries.

The definition of investing activities is added after the definition of inventories.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

The definition of minority interest is added after the definition of minimum lease payments.

Minority interest is that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.

The definition of a parent is added after the definition of an operating lease.

A ***parent*** is an entity that has one or more subsidiaries.

The definition of a subsidiary is amended (new text is underlined).

A ***subsidiary*** is an entity that is controlled by another entity (known as the parent).

The definition of a venturer is added after the definition of useful life.

A ***venturer*** is a party to a joint venture and has joint control over that joint venture.

Amendments to Section 1 *Presentation of Financial Statements*

Paragraphs 1.1, 1.19, 1.22 and 1.29 are amended (new text is underlined and deleted text is struck through).

1.1 For an entity that qualifies under the Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) to prepare and present its financial statements in accordance with the Small and Medium-sized Entity Financial Reporting Standard (SME-FRS), a complete set of separate financial statements for the entity includes the following components:

(a) a balance sheet;

(b) an income statement; ~~and~~

(c) a cash flow statement; and

(d) accounting policies and explanatory notes.

~~The SME-FRS does not apply to the preparation and presentation of consolidated financial statements.~~

1.19 The face of the balance sheet should include, where applicable, line items presenting the following amounts:

(a) property, plant and equipment;

(b) intangible assets;

(c) financial assets (including investments but excluding amounts shown under (d), (f~~e~~) and (h~~g~~));

(d) investments accounted for using the equity method;

(e~~d~~) inventories;

(f~~e~~) trade and other receivables;

(g~~f~~) tax assets;

(h~~g~~) cash and cash equivalents;

(i~~h~~) trade and other payables;

(j~~i~~) tax liabilities;

(k~~j~~) provisions;

(l~~k~~) non-current liabilities;

(m) minority interest, presented within equity;

(n~~l~~) issued capital; and

(o~~m~~) reserves attributable to equity holders of the parent.

1.22 The face of the income statement should include, where applicable, line items that present the following amounts:

(a) revenue;

(b) finance costs;

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

(d~~c~~) tax expense; and

(e~~d~~) profit or loss for the period.

The following items should be disclosed on the face of the income statement as allocations of profit or loss for the period:

(a) profit or loss attributable to minority interest; and

(b) profit or loss attributable to equity holders of the parent.

1.29 An entity should present changes in equity either in the notes to the financial statements or as a separate component of the financial statements. Changes in equity should include the following:

(a) the profit or loss for the period;

(b) each item of income and expense, gain or loss that, as required by the SME-FRS, is recognised directly in equity, and the total of these items;

(c) the total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to minority interest;

(d~~c~~) the cumulative effect of changes in accounting policy and the correction of prior period errors;

(e~~d~~) capital transactions with owners and distributions to owners;

(f~~e~~) the balance of accumulated reserves at the beginning of the period and at the balance sheet date, and the movements for the period; and

(g~~f~~) a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and end of the period, separately disclosing each movement. Comparative information is not required for this reconciliation.

Amendments to
Section 6 *Investments*

Paragraphs 6.1 and 6.11 are amended (new text is underlined and deleted text is struck through).

6.1 This Section should be applied in accounting for investments in subsidiaries, associates~~,~~ and joint ventures accounted for using the cost model and other investments in securities. This Section should not be applied in accounting for properties held for rental and/or for investment potential, investments in associates or joint ventures accounted for using the equity method as they are dealt with in Section 3 *Property, Plant and Equipment*, Section 20 *Investments in Associates* and Section 21 *Interests in Joint Ventures* respectively.

6.11 An entity should disclose:

…

(d) significant restrictions and other terms affecting the realisability of investments or the remittance of income and proceeds of disposal; and

~~(e) in respect of investments in subsidiaries, associates and joint ventures:~~

~~(i) the name of the investee;~~

~~(ii) the proportion of ownership interest in the investee;~~

~~(iii) the principal place of operation and place of incorporation of the investee; and~~

~~(iv) an indication of the nature of business of the investee; and~~

(e~~f~~) the accumulated write-down to net carrying amount (if any).

Amendments to Section 9 *Impairment of Assets*

Paragraph 9.1 is amended (new text is underlined and deleted text is struck through).

9.1 At each balance sheet date, an entity should consider whether there exists any indication of impairment and, if so, estimate the recoverable amount of all assets (including items of property, plant and equipment, intangible assets and investments in subsidiaries, associates, joint ventures and other securities) other than inventories, construction contracts and current investments. In the event that an asset's carrying amount exceeds its recoverable amount, the carrying amount should be restated to recoverable amount and an impairment loss should be recognised in the profit or loss for the period.

A heading and paragraphs 9.9-9.13 are added.

Additional requirements for impairment of goodwill

9.9 Goodwill, by itself, cannot be sold and it does not generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the recoverable amount of goodwill cannot be measured directly. Therefore, the recoverable amount of goodwill must be derived from measurement of the recoverable amount of the larger group of assets of which the goodwill is a part.

9.10 The principles in paragraphs 9.1 – 9.4 and paragraphs 9.7 and 9.8 for recognising and measuring impairment of assets apply to goodwill. Therefore, at each balance sheet date the entity should assess whether there is any indication that goodwill may be impaired. In addition to considering the indicators of impairment in paragraph 9.2, the entity should also consider whether:

(a) since acquisition, the acquired entity to which the goodwill relates has performed significantly worse than expected;

(b) the acquired entity to which the goodwill relates is being restructured, held for sale or abandoned; or

(c) significant impairment losses have been recognised for other assets of the acquired entity to which the goodwill relates.

9.11 If there is an indication that goodwill has been impaired the entity should follow a two-step process to determine whether to recognise an impairment loss:

Step 1:

(a) allocate the goodwill to the component(s) of the entity that benefit from the goodwill (generally the lowest level within the entity at which the goodwill is monitored for internal management purposes);

(b) measure the recoverable amount of each component in its entirety, including the goodwill;

(c) compare the recoverable amount of the component with the carrying amount of the component; and

(d) if the recoverable amount of the component equals or exceeds its carrying amount, neither the component nor the goodwill is impaired; if the recoverable amount of the component is less than its carrying amount, the difference is an impairment loss that should be recognised in accordance with Step 2.

Step 2:

(a) write down the component's goodwill by the amount of the loss determined in Step 1(d) and recognise an impairment loss in profit or loss; and

(b) if the amount of the loss determined in Step 1(d) exceeds the carrying amount of the component's goodwill, the excess should be recognised as an impairment loss in profit or loss. That excess should be allocated to the identifiable non-cash assets and liabilities, including contingent liabilities, of the component on the basis of their relative carrying amounts.

9.12 If there is a minority interest in the component to which goodwill has been allocated, the carrying amount of that component comprises:

(a) both the parent's interest and the minority interest in the identifiable net assets of the component; and

(b) the parent's interest in goodwill.

However, part of the recoverable amount of the component determined in accordance with Step 1(b) is attributable to the minority interest in goodwill. Consequently, any impairment loss relating to the goodwill (Step 2(a)) is apportioned between that attributable to the parent and that attributable to the minority interest, with only the former being recognised as a goodwill impairment loss.

9.13 An impairment loss recognised for goodwill should not be reversed in a subsequent period.

Amendments to
Section 15 *The Effects of Changes in Foreign Exchange Rates*

After paragraph 15.5, paragraph 15.5A is added. The heading after paragraph 15.3, paragraphs 15.4, 15.5 and 15.9 are amended (new text is underlined and delete text is struck through).

Translation of a foreign ~~branch~~operation

15.4 Where a foreign ~~branch~~operation does not form an integral part of the entity and operates as a separate business with local finance, it is not uncommon that the foreign ~~branch~~operation would report in a currency which is different from the reporting currency of the entity. Where this is the case, the results and financial position of the foreign ~~branch~~operation should be translated into the reporting currency of the entity using the following procedures:

….

15.5 On the disposal of a foreign ~~branch~~operation, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign ~~branch~~operation should be recognised in profit or loss when the gain or loss on disposal is recognised.

15.5A Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation should be treated as assets and liabilities of the foreign operation. Thus they should be expressed in the reporting currency of the foreign operation and should be translated at the closing rate.

15.9 An entity should disclose:

(a) the accounting policy adopted for foreign currency transactions, including the basis used in the translation of the foreign currency transactions, balances denominated in foreign currencies at the balance sheet date and the basis used in the translation of financial statements of foreign ~~branches~~operations and the treatment accorded to exchange differences;

…

Amendments to
Section 16 *Related Party Disclosures*

Paragraph 16.6 is amended (new text is underlined and deleted text is struck through). After paragraph 16.8, paragraph 16.9 is added.

16.6 The disclosures required by paragraph 16.5 should be made separately for each of the following categories:

(a) the parent;

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

(c) subsidiaries;

(d~~c~~) associates;

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

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

(g~~f~~) other related parties.

16.9 No disclosure of transactions is required:

(a) in consolidated financial statements in respect of intra-group transactions;

(b) in the holding company's separate financial statements when they are presented together with the consolidated financial statements;

(c) in financial statements of a wholly-owned subsidiary provided that the consolidated financial statements in which the subsidiary is included contain related party disclosures comparable to those required by this Section, and that reliance on this exemption is disclosed in the subsidiary's financial statements; and

(d) in financial statements of a reporting entity in respect of transactions that specific exemptions on disclosure are granted by statute. In such circumstances, reliance on the legal dispensation should be disclosed in the financial statements.

Amendments to
Transitional Provisions

The paragraph is amended (new text is underlined).

The transition to the SME-FRF and SME-FRS is accounted for in accordance with paragraph 27 of the SME-FRF.

<u>The transitional provisions for Section 18 *Business Combinations and Goodwill*, Section 20 *Investments in Associates* and Section 21 *Interests in Joint Ventures* should be referred to the transitional provisions set out in respective sections.</u>

Amendments to
Effective Date

The paragraph is amended (new text is underlined).

The SME-FRS becomes effective for a Qualifying Entity's financial statements that cover a period beginning on or after 1 January 2005. Earlier application is permitted.

<u>An entity should apply amendments in paragraphs 1.1, 1.19, 1.22, 1.29, 6.1, 6.11, 9.1, 9.9-9.13, 15.4, 15.5, 15.5A, 15.9, 16.6 and 16.9 for annual periods beginning on or after [Date]. Earlier application is permitted. Section 18 *Business Combinations and Goodwill*, Section 19 *Consolidated Financial Statements,* Section 20 *Investments in Associates* and Section 21 *Interests in Joint Ventures* should be adopted at the same time.</u>