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

MEMBERS' HANDBOOK

Update No. 106

(Issued 24 June 2011)

This Update relates to the issuance of:

- HKAS 27 (2011) *Separate Financial Statements*
- HKAS 28 (2011) *Investments in Associates and Joint Ventures*
- HKFRS 10 *Consolidated Financial Statements*
- HKFRS 11 *Joint Arrangements*
- HKFRS 12 *Disclosure of Interests in Other Entities*
- HKFRS 13 *Fair Value Measurement*

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard existing pages i - iii & replace with revised pages i - iii.	Revised contents pages
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 27 (Revised) *Consolidated and Separate Financial Statements*	Replace cover page with revised cover page.	- Note 1 & 3
HKAS 27 (2011) *Separate Financial Statements*	Insert these pages after HKAS 27 (Revised) *Consolidated and Separate Financial Statements*.	- Note 1 & 3
HKAS 28 *Investments in Associates*	Replace cover page with revised cover page.	- Note 1 & 3
HKAS 28 (2011) *Investments in Associates and Joint Ventures*	Insert these pages after HKAS 28 *Investments in Associates*.	- Note 1 & 3
HKAS 31 *Interests in Joint Ventures*	Replace cover page with revised cover page.	- Note 1 & 3
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 10 *Consolidated Financial Statements*	Insert these pages after HKFRS 9 *Financial Instruments*.	- Note 1 & 3

HKFRS 11 *Joint Arrangements*	Insert these pages after HKFRS 10 *Consolidated Financial Statements*.	- Note 1 & 3
HKFRS 12 *Disclosure of Interests in Other Entities*	Insert these pages after HKFRS 11 *Joint Arrangements*.	- Note 1 & 3
HKFRS 13 *Fair Value Measurement*	Insert these pages after HKFRS 12 *Disclosure of Interests in Other Entities*.	- Note 2 & 3

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

HK(SIC)-Int 12 *Consolidation – Special Purpose Entities*	Replace cover page with revised cover page.	- Note 1 & 3
HK(SIC)-Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*	Replace cover page with revised cover page.	- Note 1 & 3

Note:

1. The issuance of HKFRS 10 *Consolidated Financial Statements*, HKFRS 11 *Joint Arrangements* and HKFRS 12 *Disclosure of Interests in Other Entities* completes improvements to the accounting requirements for off balance sheet activities and joint arrangements and concludes an important element of the International Accounting Standards Board's comprehensive response to the financial crisis.

   - HKFRS 10 *Consolidated Financial Statements* builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess.

   - HKFRS 11 *Joint Arrangements* provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities.

   - HKFRS 12 *Disclosure of Interests in Other Entities* is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles.

2. HKFRS 13 *Fair Value Measurement* improves consistency and reduces complexity by providing, for the first time, a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting, but provide guidance on how it should be applied where its use is already required or permitted by other standards within HKFRSs.

3. The above-mentioned standards are effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

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HKAS 27 (Revised)
Revised ~~July 2010~~June 2011

Effective for annual periods beginning on or after 1 July 2009*

Hong Kong Accounting Standard 27 (Revised)

Consolidated and Separate Financial Statements

*HKAS 27 (Revised) is applicable for annual periods beginning on or after 1 July 2009 but before 1 January 2013. HKAS 27 (2011) and HKFRS 10 *Consolidated Financial Statements* issued in June 2011 are applicable for annual periods beginning on or after 1 January 2013 and supersede HKAS 27 (Revised).

Hong Kong Institute of
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HKAS 27 (2011)
Issued June 2011

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Accounting Standard 27 (2011)

Separate Financial Statements

Hong Kong Institute of
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Introduction

IN1 HKAS 27 *Separate Financial Statements* contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The Standard requires an entity preparing separate financial statements to account for those investments at cost or in accordance with HKFRS 9 *Financial Instruments*.

IN2 The Standard is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Hong Kong Accounting Standard 27
Separate Financial Statements

Objective

1 The objective of this Standard is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

Scope

2 This Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by local regulations, to present separate financial statements.

3 This Standard does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with Hong Kong Financial Reporting Standards.

Definitions

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

***Consolidated financial statements* are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.**

***Separate financial statements* are those presented by a parent (ie an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with HKFRS 9 *Financial Instruments*.**

5 The following terms are defined in Appendix A of HKFRS 10 *Consolidated Financial Statements*, Appendix A of HKFRS 11 *Joint Arrangements* and paragraph 3 of HKAS 28 *Investments in Associates and Joint Ventures*:

- associate
- control of an investee
- group
- joint control
- joint venture
- joint venturer
- parent
- significant influence
- subsidiary.

6 Separate financial statements are those presented in addition to consolidated financial statements or in addition to financial statements in which investments in associates or joint ventures are accounted for using the equity method, other than in the circumstances set out in paragraph 8. Separate financial statements need not be appended to, or accompany, those statements.

7 Financial statements in which the equity method is applied are not separate financial statements. Similarly, the financial statements of an entity that does not have a subsidiary, associate or joint venturer's interest in a joint venture are not separate financial statements.

8 An entity that is exempted in accordance with paragraph 4(a) of HKFRS 10 from consolidation or paragraph 17 of HKAS 28 (as amended in 2011) from applying the equity method may present separate financial statements as its only financial statements.

Preparation of separate financial statements

9 Separate financial statements shall be prepared in accordance with all applicable HKFRSs, except as provided in paragraph 10.

10 When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:

(a) at cost, or

(b) in accordance with HKFRS 9.

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when they are classified as held for sale (or included in a disposal group that is classified as held for sale). The measurement of investments accounted for in accordance with HKFRS 9 is not changed in such circumstances.

11 If an entity elects, in accordance with paragraph 18 of HKAS 28 (as amended in 2011), to measure its investments in associates or joint ventures at fair value through profit or loss in accordance with HKFRS 9, it shall also account for those investments in the same way in its separate financial statements.

12 An entity shall recognise a dividend from a subsidiary, a joint venture or an associate in profit or loss in its separate financial statements when its right to receive the dividend is established.

13 When a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:

(a) the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;

(b) the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and

(c) the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganisation,

and the new parent accounts for its investment in the original parent in accordance with paragraph 10(a) in its separate financial statements, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

14 Similarly, an entity that is not a parent might establish a new entity as its parent in a manner that satisfies the criteria in paragraph 13. The requirements in paragraph 13 apply equally to such reorganisations. In such cases, references to 'original parent' and 'original group' are to the 'original entity'.

Disclosure

15 An entity shall apply all applicable HKFRSs when providing disclosures in its separate financial statements, including the requirements in paragraphs 16 and 17.

16 When a parent, in accordance with paragraph 4(a) of HKFRS 10, elects not to prepare consolidated financial statements and instead prepares separate financial statements, it shall disclose in those separate financial statements:

(a) the fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name and principal place of business (and country of incorporation, if different) of the entity whose consolidated financial statements that comply with Hong Kong Financial Reporting Standards or International Financial Reporting Standards have been produced for public use; and the address where those consolidated financial statements are obtainable.

(b) a list of significant investments in subsidiaries, joint ventures and associates, including:

(i) the name of those investees.

(ii) the principal place of business (and country of incorporation, if different) of those investees.

(iii) its proportion of the ownership interest (and its proportion of the voting rights, if different) held in those investees.

(c) a description of the method used to account for the investments listed under (b).

17 When a parent (other than a parent covered by paragraph 16) or an investor with joint control of, or significant influence over, an investee prepares separate financial statements, the parent or investor shall identify the financial statements prepared in accordance with HKFRS 10, HKFRS 11 or HKAS 28 (as amended in 2011) to which they relate. The parent or investor shall also disclose in its separate financial statements:

(a) the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law.

(b) a list of significant investments in subsidiaries, joint ventures and associates, including:

(i) the name of those investees.

(ii) the principal place of business (and country of incorporation, if different) of those investees.

(iii) its proportion of the ownership interest (and its proportion of the voting rights, if different) held in those investees.

(c) a description of the method used to account for the investments listed under (b).

The parent or investor shall also identify the financial statements prepared in accordance with HKFRS 10, HKFRS 11 or HKAS 28 (as amended in 2011) to which they relate.

Effective date and transition

18 An entity shall apply this Standard for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this Standard earlier, it shall disclose that fact and apply HKFRS 10, HKFRS 11, HKFRS 12 *Disclosure of Interests in Other Entities* and HKAS 28 (as amended in 2011) at the same time.

References to HKFRS 9

19 If an entity applies this Standard but does not yet apply HKFRS 9, any reference to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*.

Withdrawal of HKAS 27 (Revised)

20 This Standard is issued concurrently with HKFRS 10. Together, the two HKFRSs supersede HKAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008).

Appendix
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 27.

The International Accounting Standard comparable with HKAS 27 is IAS 27 *Separate Financial Statements*.

There are no major textual differences between HKAS 27 and IAS 27.

Basis for Conclusions on IAS 27 *Separate Financial Statements*

This Basis for Conclusions accompanies, but is not part of, IAS 27.

HKAS 27 is based on IAS 27 *Separate Financial Statements*. In approving HKAS 27, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 27. Accordingly, there are no significant differences between HKAS 27 and IAS 27. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 27 referred to below generally correspond with those in HKAS 27.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on issuing IAS 27 *Consolidated and Separate Financial Statements* in 2003, and amending IAS 27 in 2008 and again in 2011. Individual Board members gave greater weight to some factors than to others. Unless otherwise noted, references below to IAS 27 are to previous versions of the Standard.

BC2 The amendment of IAS 27 in 2011 resulted from the Board's project on consolidation. A new IFRS, IFRS 10 *Consolidated Financial Statements,* addresses the principle of control and requirements relating to the preparation of consolidated financial statements. As a result, IAS 27 now contains requirements relating only to separate financial statements. This change is reflected in the Standard's amended title, *Separate Financial Statements*.

BC3 In approving the publication of IFRS 10 in 2011, the Board also approved consequential amendments to IAS 27 that removed from the Standard all requirements relating to consolidated financial statements.

BC4 At the same time, the Board relocated to IAS 27 requirements from IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* regarding separate financial statements. Those requirements are in paragraphs 6–8 of the Standard. Given the extent of the material that has been removed or relocated, the Board decided, for clarity, to renumber the paragraphs in the amended IAS 27. The definitions and wording in the Standard were also updated to be consistent with the requirements in IFRS 10, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, and IAS 28 *Investments in Associates and Joint Ventures*.

BC5 When issued in 2003, IAS 27 was accompanied by a Basis for Conclusions summarising the considerations of the Board, as constituted at the time, in reaching its conclusions. The Basis for Conclusions was subsequently updated to reflect amendments to the Standard.

BC6 This Basis for Conclusions now includes only the Board's considerations on separate financial statements. Cross-references have been updated accordingly and minor necessary editorial changes have been made. The paragraphs discussing consolidated financial statements have been relocated to the Basis for Conclusions on IFRS 10 as appropriate.

Consolidation exemption available for non-public entities

BC7 The Board decided that a parent that meets the criteria in paragraph 4(a) of IFRS 10 for exemption from the requirement to prepare consolidated financial statements should, in its separate financial statements, account for those subsidiaries in the same way as other parents, joint venturers with interests in joint ventures or investors in associates account for investments in their separate financial statements. The Board draws a distinction between accounting for such investments as equity investments and accounting for the economic entity that the parent controls. In relation to the former, the Board decided that each category of investment should be accounted for consistently.

BC8 The Board decided that the same approach to accounting for investments in separate financial statements should apply irrespective of the circumstances for which they are prepared. Thus, a parent that presents consolidated financial statements, and a parent that does not because it is exempted, should present the same form of separate financial statements.

Measurement of investments in subsidiaries, joint ventures and associates in separate financial statements (2003 revision and 2008 amendments)

BC9 IAS 27 (as revised by the Board's predecessor body in 2000) permitted entities to measure investments in subsidiaries in any one of three ways in the parent's separate financial statements. These were at cost, using the equity method, or as available-for-sale[*] financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.[†] IAS 28 *Investments in Associates* permitted the same choices for investments in associates in separate financial statements, and IAS 31 *Interests in Joint Ventures* stated that IAS 31 did not indicate a preference for any particular treatment for accounting for interests in joint ventures in a joint venturer's separate financial statements. However, in 2003 the Board decided to require the use of cost or IAS 39 for all investments included in separate financial statements and to remove the equity method as one of the measurement options.

BC10 Although the equity method would provide users with some profit or loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's consolidated or individual financial statements and does not need to be provided to the users of its separate financial statements. For separate financial statements, the focus is upon the performance of the assets as investments. The Board concluded that separate financial statements prepared using either the fair value method in accordance with IAS 39[‡] or the cost method would be relevant. Using the fair value method in accordance with IAS 39 would provide a measure of the economic value of the investments. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. For example, they may be needed only by particular parties to determine the dividend income from subsidiaries.

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[*] IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets.

[†] In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

[‡] In May 2011 the Board issued IFRS 13 *Fair Value Measurement*, which contains requirements for measuring fair value.

BC11 As part of its annual improvements project begun in 2007, the Board identified an apparent inconsistency with IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations*. The inconsistency related to the accounting by a parent in its separate financial statements when investments it accounts for in accordance with IAS 39 are classified as held for sale in accordance with IFRS 5. Paragraph 10 requires an entity that prepares separate financial statements to account for such investments that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 if they are measured at cost. However, financial assets that an entity accounts for in accordance with IAS 39 are excluded from IFRS 5's measurement requirements.

BC12 Paragraph BC13 of the Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5 only 'if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell.'* The Board acknowledged in the Basis for Conclusions on IFRS 5 that not all financial assets within the scope of IAS 39 are recognised at fair value with changes in fair value recognised in profit or loss, but it did not want to make any further changes to the accounting for financial assets at that time.

BC13 Therefore, the Board amended paragraph 10 by *Improvements to IFRSs* issued in May 2008 to align the accounting in separate financial statements for those investments that are accounted for in accordance with IAS 39 with the measurement exclusion that IFRS 5 provides for other assets that are accounted for in accordance with IAS 39 before classification as held for sale. Thus, an entity should continue to account for such investments in accordance with IAS 39 when they meet the held for sale criteria in IFRS 5.

Dividend received from a subsidiary, a joint venture or an associate

BC14 Before *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* was issued in May 2008, IAS 27 described a 'cost method'. This required an entity to recognise distributions as income only if they came from post-acquisition retained earnings. Distributions received in excess of such retained earnings were regarded as a recovery of investment and were recognised as a reduction in the cost of the investment. To apply that method retrospectively upon first-time adoption of IFRSs in its separate financial statements, an investor would need to know the subsidiary's pre-acquisition retained earnings in accordance with IFRSs.

BC15 Restating pre-acquisition retained earnings would be a task tantamount to restating the business combination (for which IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides an exemption in Appendix C). It might involve subjective use of hindsight, which would diminish the relevance and reliability of the information. In some cases, the restatement would be time-consuming and difficult. In other cases, it would be impossible (because it would involve making judgements about the fair values of the assets and liabilities of a subsidiary at the acquisition date).

BC16 Therefore, in *Cost of an Investment in a Subsidiary*, an exposure draft of proposed amendments to IFRS 1 (published in January 2007), the Board proposed to give first-time adopters an exemption from restating the retained earnings of the subsidiary at the date of acquisition for the purpose of applying the cost method.

* In May 2011 the Board issued IFRS 13 Fair Value Measurement, which contains requirements for measuring fair value.

BC17 In considering the responses to that exposure draft, the Board observed that the principle underpinning the cost method is that a return of an investment should be deducted from the carrying amount of the investment. However, the wording in the previous version of IAS 27 created a problem in some jurisdictions because it made specific reference to retained earnings as the means of making that assessment. The Board decided that the best way to resolve this issue was to delete the definition of the cost method.

BC18 In removing the definition of the cost method, the Board concluded that an investor should recognise a dividend from a subsidiary, a joint venture or an associate as income in its separate financial statements. Consequently, the requirement to separate the retained earnings of an entity into pre-acquisition and post-acquisition components as a method for assessing whether a dividend is a recovery of its associated investment has been removed from IFRSs.

BC19 To reduce the risk that removing the definition of the cost method would lead to investments in subsidiaries, joint ventures and associates being overstated in the separate financial statements of the investor, the Board proposed that the related investment should be tested for impairment in accordance with IAS 36 *Impairment of Assets*.

BC20 The Board published its revised proposals in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, an exposure draft of proposed amendments to IFRS 1 and IAS 27, in December 2007. Respondents generally supported the proposed amendments to IAS 27, except for the proposal to require impairment testing of the related investment when an investor recognises a dividend. In the light of the comments received, the Board revised its proposal and identified specific indicators of impairment. This was done to narrow the circumstances in which impairment testing of the related investment would be required when an investor recognises a dividend (see paragraph 12(h) of IAS 36). The Board included the amendments in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* issued in May 2008.

Measurement of cost in the separate financial statements of a new parent

BC21 In 2007 the Board received enquiries about the application of paragraph 10(a) when a parent reorganises the structure of its group by establishing a new entity as its parent. The new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent.

BC22 In this type of reorganisation, the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation. In addition, the owners of the original parent have the same relative and absolute interests in the net assets of the new group immediately after the reorganisation as they had in the net assets of the original group before the reorganisation. Finally, this type of reorganisation involves an existing entity and its shareholders agreeing to create a new parent between them. In contrast, many transactions or events that result in a parent-subsidiary relationship are initiated by a parent over an entity that will be positioned below it in the structure of the group.

BC23 Therefore, the Board decided that in applying paragraph 10(a) *in the limited circumstances in which a parent establishes a new parent in this particular manner*, the new parent should measure the cost of its investment in the original parent at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation. In December 2007 the Board published an exposure draft proposing to amend IAS 27 to add a paragraph with that requirement.

BC24 In response to comments received from respondents to that exposure draft, the Board modified the drafting of the amendment (paragraphs 13 and 14) to clarify that it applies to the following types of reorganisations when they satisfy the criteria specified in the amendment:

(a) reorganisations in which the new parent does not acquire all the equity instruments of the original parent. For example, a new parent might issue equity instruments in exchange for ordinary shares of the original parent, but not acquire the preference shares of the original parent. In addition, a new parent might obtain control of the original parent, but not acquire all the ordinary shares of the original parent.

(b) the establishment of an intermediate parent within a group, as well as the establishment of a new ultimate parent of a group.

(c) reorganisations in which an entity that is not a parent establishes a new entity as its parent.

BC25 In addition, the Board clarified that the amendment focuses on the measurement of one asset—the new parent's investment in the original parent in the new parent's separate financial statements. The amendment does not apply to the measurement of any other assets or liabilities in the separate financial statements of either the original parent or the new parent or in the consolidated financial statements.

BC26 The Board included the amendment in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* issued in May 2008.

BC27 The Board did not consider the accounting for other types of reorganisations or for common control transactions more broadly. Accordingly, paragraphs 13 and 14 apply only when the criteria in those paragraphs are satisfied. Therefore, the Board expects that entities would continue to account for transactions that do not satisfy the criteria in paragraphs 13 and 14 in accordance with their accounting policies for such transactions. The Board plans to consider the definition of common control and the accounting for business combinations under common control in a future project on common control transactions.

Disclosure (2011 amendments)

BC28 When IAS 27 was amended in 2011, the Board clarified the disclosures required by an entity preparing separate financial statements so that the entity would be required to disclose the principal place of business (and country of incorporation, if different) of significant investments in subsidiaries, joint ventures and associates and, if applicable, of the parent that prepares consolidated financial statements that comply with IFRSs. IAS 27 (as amended in 2008) had previously required the disclosure of the country of incorporation or residence of such entities. The clarification of the disclosure requirement is more consistent with those requirements in other IFRSs (eg IFRS 12 and IAS 1 *Presentation of Financial Statements*) that also require disclosure of the principal place of business and country of incorporation.

Effective date (2011 amendments)

BC29 The Board decided to align the effective date for the Standard with the effective date for IFRS 10, IFRS 11, IFRS 12 and IAS 28 (as amended in 2011). When making this decision, the Board noted that the five IFRSs all deal with the assessment of, and related accounting and disclosure requirements about, a reporting entity's special relationships with other entities (ie when the reporting entity has control or joint control of, or significant influence over, another entity). As a result, the Board concluded that applying IAS 27 without also applying the other four IFRSs could cause unwarranted confusion.

BC30 The Board usually sets an effective date of between twelve and eighteen months after issuing an IFRS. When deciding the effective date for the five IFRSs, the Board considered the following factors:

(a) the time that many countries require for translation and for introducing the mandatory requirements into law.

(b) the consolidation project was related to the global financial crisis that started in 2007 and was accelerated by the Board in response to urgent requests from the leaders of the G20, the Financial Stability Board, users of financial statements, regulators and others to improve the accounting and disclosure of an entity's 'off balance sheet' activities.

(c) the comments received from respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 regarding implementation costs, effective date and transition requirements of the IFRSs to be issued in 2011. Most respondents did not identify the consolidation and joint arrangements IFRSs as having a high impact in terms of the time and resources that their implementation would require. In addition, only a few respondents commented that the effective dates of those IFRSs should be aligned with those of the other IFRSs to be issued in 2011.

BC31 With these factors in mind, the Board decided to require entities to apply the five IFRSs for annual periods beginning on or after 1 January 2013.

BC32 Most respondents to the Request for Views supported early application of the IFRSs to be issued in 2011. Respondents stressed that early application was especially important for first-time adopters in 2011 and 2012. The Board was persuaded by these arguments and decided to permit early application of IAS 27 but only if an entity applies it in conjunction with the other IFRSs (ie IFRS 10, IFRS 11, IFRS 12 and IAS 28 (as amended in 2011)) to avoid a lack of comparability among financial statements, and for the reasons noted in paragraph BC29 that triggered the Board's decision to set the same effective date for all five IFRSs. Even though an entity should apply the five IFRSs at the same time, the Board noted that an entity should not be prevented from providing any information required by IFRS 12 early if by doing so users gained a better understanding of the entity's relationships with other entities.

Dissent of Mary E Barth and Philippe Danjou from *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 and IAS 27) issued in May 2008

Cross-references have been updated.

DO1 Professor Barth and Mr Danjou voted against the publication of *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements*). The reasons for their dissent are set out below.

DO2 These Board members disagree with the **requirement** in paragraphs 13 and 14 of IAS 27 that when a reorganisation satisfies the criteria specified in those paragraphs and the resulting new parent accounts for its investment in the original parent at cost in accordance with paragraph 10(a) of IAS 27, the new parent must measure the cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

DO3 These Board members acknowledge that a new parent could choose to apply paragraph 10(b) of IAS 27 and account for its investment in the original parent in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. However, the new parent then would be required to account for the investment in accordance with IAS 39 in subsequent periods and to account for all other investments in the same category in accordance with IAS 39.*

DO4 These Board members also acknowledge, as outlined in paragraph BC23 of the Basis for Conclusions on IAS 27, that this type of reorganisation is different from other types of reorganisations in that the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation, as are the interests of the owners of the original parent in the net assets of those groups. Therefore, using the previous carrying amount to measure the cost of the new parent's investment in the original parent might be appropriate on the basis that the separate financial statements of the new parent would reflect its position as part of a pre-existing group.

DO5 However, these Board members believe that it is inappropriate to preclude a new parent from measuring the cost of its investment in the original parent at the fair value of the shares that it issues as part of the reorganisation. Separate financial statements are prepared to reflect the parent as a separate legal entity (ie not considering that the entity might be part of a group). Although such a reorganisation does not change the assets and liabilities of the group and therefore should have no accounting effect at the consolidated level, from the perspective of the new parent as a separate legal entity, its position has changed—it has issued shares and acquired an investment that it did not have previously. Also, in many jurisdictions, commercial law or corporate governance regulations require entities to measure new shares that they issue at the fair value of the consideration received for the shares.

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

DO6 These Board members believe that the appropriate measurement basis for the new parent's cost of its investment in the original parent depends on the Board's view of separate financial statements. The Board is or will be discussing related issues in the reporting entity phase of its Conceptual Framework project and in its project on common control transactions. Accordingly, these Board members believe that the Board should have permitted a new parent to measure the cost of its investment in the original parent either at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent or at the fair value of the equity instruments that it issues until the Board discusses the related issues in its projects on reporting entity and common control transactions.

Table of Concordance

This table shows how the contents of HKAS 27 *Consolidated and Separate Financial Statements* (the 'superseded HKAS 27') and HKAS 27 *Separate Financial Statements* (the 'amended HKAS 27') correspond. Some requirements in the superseded version of HKAS 27 were incorporated into HKFRS 10 and HKFRS 12; this table also shows how those paragraphs correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the requirements may differ.

Superseded HKAS 27 paragraph	Amended HKAS 27 paragraph	HKFRS 10 paragraph	HKFRS 12 paragraph
1		1	
2		3	
3	2		
4	4, 5	Appendix A	
5			
6–8	6–8		
9		1, 2	
10		4(a)	
11			
12		Appendix A	
13		7	
14		B47	
15		B48, B49	
16, 17			
18		B86	
19		B89	
20, 21		B86(c)	
22, 23		B92, B93	
24		19	
25, 26		B87, B88	
27		22	
28, 29		B94, B95	
30		23	
31		B96	
32		B83	
33–35		B97–B99	

36		25(b)	
37		25(b)	
38	10		
38A–38C	12–14		
39	3		
40	11		
41			10–19
42, 43	16, 17		
44–45E	18		
46	20		
None	1, 9, 15, 19		

The main change made in June 2011 was that HKFRS 10 *Consolidated Financial Statements* replaced the consolidation requirements in HKAS 27. Only accounting and disclosure requirements for the preparation of separate financial statements remained in HKAS 27; the Standard was therefore renamed *Separate Financial Statements*.

HKAS 28
Revised ~~July 2010~~June 2011

Effective for annual periods
beginning on or after 1 January 2005*

Hong Kong Accounting Standard 28

Investments in Associates

An entity shall apply amendments resulting from *Improvements to HKFRSs* issued in May 2010 for annual periods beginning on or after 1 July 2010.

*HKAS 28 is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2013. HKAS 28 (2011) issued in June 2011 is applicable for annual periods beginning on or after 1 January 2013 and supersedes HKAS 28 issued in 2004.

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

HKAS 28 (2011)
Issued June 2011

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Accounting Standard 28 (2011)

Investments in Associates and Joint Ventures

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

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Hong Kong Accounting Standard 28 *Investments in Associates and Joint Ventures* (HKAS 28) is set out in paragraphs 1–47. All the paragraphs have equal authority. HKAS 28 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 28 *Investments in Associates and Joint Ventures* (HKAS 28) prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

IN2 The Standard is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Main features of the Standard

IN3 HKAS 28 (as amended in 2011) is to be applied by all entities that are investors with joint control of, or significant influence over, an investee.

IN4 The Standard defines significant influence as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

IN5 HKFRS 11 *Joint Arrangements* establishes principles for the financial reporting of parties to joint arrangements. It defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

IN6 An entity applies HKFRS 11 to determine the type of joint arrangement in which it is involved. Once it has determined that it has an interest in a joint venture, the entity recognises an investment and accounts for it using the equity method in accordance with HKAS 28 (as amended in 2011), unless the entity is exempted from applying the equity method as specified in the Standard.

Equity method

IN7 The Standard defines the equity method as a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The profit or loss of the investor includes its share of the profit or loss of the investee and the other comprehensive income of the investor includes its share of other comprehensive income of the investee.

IN8 An entity uses the equity method to account for its investments in associates or joint ventures in its consolidated financial statements. An entity that does not have any subsidiaries also uses the equity method to account for its investments in associates or joint ventures in its financial statements even though those are not described as consolidated financial statements. The only financial statements to which an entity does not apply the equity method are separate financial statements it presents in accordance with HKAS 27 *Separate Financial Statements*.

Exemptions from applying the equity method

IN9 The Standard provides exemptions from applying the equity method similar to those provided in HKFRS 10 *Consolidated Financial Statements* for parents not to prepare consolidated financial statements.

IN10 The Standard also provides exemptions from applying the equity method when the investment in the associate or joint venture is held by, or is held indirectly through, venture capital organisations, or mutual funds, unit trusts and similar entities including investment-linked insurance funds. Those investments in associates and joint ventures may be measured at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments.*

Disclosure

IN11 The disclosure requirements for entities with joint control of, or significant influence over, an investee are specified in HKFRS 12 *Disclosure of Interests in Other Entities*.

Hong Kong Accounting Standard 28
Investments in Associates and Joint Ventures

Objective

1 **The objective of this Standard is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.**

Scope

2 **This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee.**

Definitions

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

An *associate* is an entity over which the investor has significant influence.

***Consolidated financial statements* are the financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.**

The *equity method* is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

A *joint arrangement* is an arrangement of which two or more parties have joint control.

***Joint control* is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.**

A *joint venture* is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

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

***Significant influence* is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.**

4 The following terms are defined in paragraph 4 of HKAS 27 *Separate Financial Statements* and in Appendix A of HKFRS 10 *Consolidated Financial Statements* and are used in this Standard with the meanings specified in the HKFRSs in which they are defined:

- control of an investee
- group
- parent
- separate financial statements
- subsidiary.

Significant influence

5 If an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

6 The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

(a) representation on the board of directors or equivalent governing body of the investee;

(b) participation in policy-making processes, including participation in decisions about dividends or other distributions;

(c) material transactions between the entity and its investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

7 An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (ie potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

8 In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.

9 An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual arrangement.

Equity method

10 Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss 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 changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see HKAS 1 *Presentation of Financial Statements*).

11 The recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate or a joint venture because the distributions received may bear little relation to the performance of the associate or joint venture. Because the investor has joint control of, or significant influence over, the investee, the investor has an interest in the associate's or joint venture's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of the profit or loss of such an investee. As a result, application of the equity method provides more informative reporting of the investor's net assets and profit or loss.

12 When potential voting rights or other derivatives containing potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments, unless paragraph 13 applies.

13 In some circumstances, an entity has, in substance, an existing ownership as a result of a transaction that currently gives it access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the returns.

14 HKFRS 9 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture, the instruments are not subject to HKFRS 9. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with HKFRS 9.

15 Unless an investment, or a portion of an investment, in an associate or a joint venture is classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the investment, or any retained interest in the investment not classified as held for sale, shall be classified as a non-current asset.

Application of the equity method

16 An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 17–19.

Exemptions from applying the equity method

17 An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of HKFRS 10 or if all the following apply:

(a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.

(b) The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

(c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market.

(d) The ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with HKFRSs or International Financial Reporting Standards.

18 When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with HKFRS 9.

19 When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with HKFRS 9 regardless of whether the venture capital organisation, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds.

Classification as held for sale

20 An entity shall apply HKFRS 5 to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. Any retained portion of an investment in an associate or a joint venture that has not been classified as held for sale shall be accounted for using the equity method until disposal of the portion that is classified as held for sale takes place. After the disposal takes place, an entity shall account for any retained interest in the associate or joint venture in accordance with HKFRS 9 unless the retained interest continues to be an associate or a joint venture, in which case the entity uses the equity method.

21 When an investment, or a portion of an investment, in an associate or a joint venture previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method retrospectively as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.

Discontinuing the use of the equity method

22 An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:

(a) If the investment becomes a subsidiary, the entity shall account for its investment in accordance with HKFRS 3 *Business Combinations* and HKFRS 10.

(b) If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with HKFRS 9. The entity shall recognise in profit or loss any difference between:

(i) the fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and

(ii) the carrying amount of the investment at the date the equity method was discontinued.

(c) When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognised in other comprehensive income in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.

23 Therefore, if a gain or loss previously recognised in other comprehensive income by the investee would be reclassified to profit or loss on the disposal of the related assets or liabilities, the entity reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when the equity method is discontinued. For example, if an associate or a joint venture has cumulative exchange differences relating to a foreign operation and the entity discontinues the use of the equity method, the entity shall reclassify to profit or loss the gain or loss that had previously been recognised in other comprehensive income in relation to the foreign operation.

24 If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest.

Changes in ownership interest

25 If an entity's ownership interest in an associate or a joint venture is reduced, but the entity continues to apply the equity method, the entity shall reclassify to profit or loss the proportion of the gain or loss that had previously been recognised in other comprehensive income relating to that reduction in ownership interest if that gain or loss would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities.

Equity method procedures

26 Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in HKFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

27 A group's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the parent and its subsidiaries. The holdings of the group's other associates or joint ventures are ignored for this purpose. When an associate or a joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 35 and 36).

28 Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. 'Upstream' transactions are, for example, sales of assets from an associate or a joint venture to the investor. 'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture. The investor's share in the associate's or joint venture's gains or losses resulting from these transactions is eliminated.

29 When downstream transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognised in full by the investor. When upstream transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, the investor shall recognise its share in those losses.

30 The contribution of a non-monetary asset to an associate or a joint venture in exchange for an equity interest in the associate or joint venture shall be accounted for in accordance with paragraph 28, except when the contribution lacks commercial substance, as that term is described in HKAS 16 *Property, Plant and Equipment*. If such a contribution lacks commercial substance, the gain or loss is regarded as unrealised and is not recognised unless paragraph 31 also applies. Such unrealised gains and losses shall be eliminated against the investment accounted for using the equity method and shall not be presented as deferred gains or losses in the entity's consolidated statement of financial position or in the entity's statement of financial position in which investments are accounted for using the equity method.

31 If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity recognises in full in profit or loss the portion of the gain or loss on the non-monetary contribution relating to the monetary or non-monetary assets received.

32 An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

(a) Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

(b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired.

Appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made for impairment losses such as for goodwill or property, plant and equipment.

33 The most recent available financial statements of the associate or joint venture are used by the entity in applying the equity method. When the end of the reporting period of the entity is different from that of the associate or joint venture, the associate or joint venture prepares, for the use of the entity, financial statements as of the same date as the financial statements of the entity unless it is impracticable to do so.

34 When, in accordance with paragraph 33, the financial statements of an associate or a joint venture used in applying the equity method are prepared as of a date different from that used by the entity, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the entity's financial statements. In any case, the difference between the end of the reporting period of the associate or joint venture and that of the entity shall be no more than three months. The length of the reporting periods and any difference between the ends of the reporting periods shall be the same from period to period.

35 The entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.

36 If an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments shall be made to make the associate's or joint venture's accounting policies conform to those of the entity when the associate's or joint venture's financial statements are used by the entity in applying the equity method.

37 If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity computes its share of profit or loss after adjusting for the dividends on such shares, whether or not the dividends have been declared.

38 If an entity's share of losses of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognising its share of further losses. The interest in an associate or a joint venture is the carrying amount of the investment in the associate or joint venture determined using the equity method together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. 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 or joint venture. 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 using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (ie priority in liquidation).

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

Impairment losses

40 After application of the equity method, including recognising the associate's or joint venture's losses in accordance with paragraph 38, the entity applies HKAS 39 *Financial Instruments: Recognition and Measurement* to determine whether it is necessary to recognise any additional impairment loss with respect to its net investment in the associate or joint venture.

41 The entity also applies HKAS 39 to determine whether any additional impairment loss is recognised with respect to its interest in the associate or joint venture that does not constitute part of the net investment and the amount of that impairment loss.

42 Because goodwill that forms part of the carrying amount of an investment in an associate or a joint venture is not separately recognised, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in HKAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested for impairment in accordance with HKAS 36 as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of HKAS 39 indicates that the investment may be impaired. An impairment loss recognised in those circumstances is not allocated to any asset, including goodwill, that forms part of the carrying

amount of the investment in the associate or joint venture. Accordingly, any reversal of that impairment loss is recognised in accordance with HKAS 36 to the extent that the recoverable amount of the investment subsequently increases. In determining the value in use of the investment, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment; or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.

43 The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

Separate financial statements

44 An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with paragraph 10 of HKAS 27 (as amended in 2011).

Effective date and transition

45 An entity shall apply this Standard for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this Standard earlier, it shall disclose that fact and apply HKFRS 10, HKFRS 11 *Joint Arrangements*, HKFRS 12 *Disclosure of Interests in Other Entities* and HKAS 27 (as amended in 2011) at the same time.

References to HKFRS 9

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

Withdrawal of HKAS 28 (2004)

47 This Standard supersedes HKAS 28 *Investments in Associates* (issued in 2004).

Appendix
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 28.

The International Accounting Standard comparable with HKAS 28 is IAS 28 *Investments in Associates and Joint Ventures*.

There are no major textual differences between HKAS 28 and IAS 28.

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Basis for Conclusions on IAS 28 *Investments in Associates and Joint Ventures*

This Basis for Conclusions accompanies, but is not part of, IAS 28.

HKAS 28 is based on IAS 28 *Investments in Associates and Joint Ventures*. In approving HKAS 28, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 28. Accordingly, there are no significant differences between HKAS 28 and IAS 28. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 28 referred to below generally correspond with those in HKAS 28.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on amending IAS 28 *Investments in Associates* in 2011. Individual Board members gave greater weight to some factors than to others.

BC2 The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures into IAS 28 because the equity method is applicable to both joint ventures and associates.

BC3 As a result, the title of IAS 28 was changed to *Investments in Associates and Joint Ventures*. Because the Board's intention was not to reconsider the fundamental approach to the accounting for investments in associates established by IAS 28, the Board has incorporated into its Basis for Conclusions on IAS 28 material from the Basis for Conclusions on IAS 28 (as revised in 2003) that the Board has not reconsidered.

The structure of IAS 28 and the Board's deliberations

BC4 IAS 28 as amended in 2011 superseded IAS 28 (as revised in 2003 and amended in 2010). As stated in paragraph BC3, in amending IAS 28, the Board did not reconsider all the Standard's requirements. The requirements in paragraphs 5–11, 15, 22–23, 25–28 and 32–43 relate to the assessment of significant influence and to the equity method and its application, and paragraphs 12–14 relate to the accounting for potential voting rights. With the exception of the Board's decision to incorporate the accounting for joint ventures into IAS 28, those paragraphs were carried forward from IAS 28 and from the Guidance on Implementing IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* that was withdrawn when IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IAS 28 (as amended in 2011) were issued. As a result, those paragraphs were not reconsidered by the Board.

BC5 When revised in 2003 IAS 28 was accompanied by a Basis for Conclusions summarising the considerations of the Board, as constituted at the time, in reaching its conclusions. That Basis for Conclusions was subsequently updated to reflect amendments to the Standard.

BC6 The Board has incorporated into its Basis for Conclusions on IAS 28 (as amended in 2011) material from the previous Basis for Conclusions because it discusses matters that the Board has not reconsidered. That material is contained in paragraphs denoted by numbers with the prefix BCZ. In those paragraphs cross-references have been updated accordingly and minor necessary editorial changes have been made.

BC7 One Board member dissented from an amendment to IAS 28 issued in May 2008, which has been carried forward to IAS 28 (as amended in 2011). His dissenting opinion is also set out after this Basis for Conclusions.

BC8 The requirements in paragraphs 2, 16–21, 24 and 29–31 relate to matters addressed within the joint ventures project that led to amendments to IAS 28. Paragraphs describing the Board's considerations in reaching its conclusions on IAS 28 are numbered with the prefix BC.

BC9 As part of its project on consolidation, the Board is examining how an investment entity accounts for its interests in subsidiaries, joint ventures and associates. The outcome might affect how organisations such as venture capital organisations, or mutual funds, unit trusts and similar entities account for their interests in joint ventures and associates. The Board expects to publish later in 2011 an exposure draft on investment entities.

Scope

BC10 During its redeliberation of the exposure draft ED 9 *Joint Arrangements*, the Board reconsidered the scope exception of IAS 31 that had also been proposed in ED 9. The Board concluded that the scope exception in ED 9 for interests in joint ventures held by venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, that are measured at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* is more appropriately characterised as a measurement exemption, and not as a scope exception.

BC11 The Board observed that IAS 28 had a similar scope exception for investments in associates held by venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, that are measured at fair value through profit or loss in accordance with IFRS 9.

BC12 The Board observed that the scope exception in ED 9 and IAS 28 related not to the fact that these arrangements do not have the characteristics of joint arrangements or those investments are not associates, but to the fact that for investments held by venture capital organisations, or mutual funds, unit trusts and similar entities including investment-linked insurance funds, fair value measurement provides more useful information for users of the financial statements than would application of the equity method.

BC13 Accordingly, the Board decided to maintain the option that permits venture capital organisations, or mutual funds, unit trusts and similar entities including investment-linked insurance funds to measure their interests in joint ventures and associates at fair value through profit or loss in accordance with IFRS 9, but clarified that this is an exemption from the requirement to measure interests in joint ventures and associates using the equity method, rather than an exception to the scope of IAS 28 for the accounting for joint ventures and associates held by those entities.

BC14 As a result of that decision and of the decision to incorporate the accounting for joint ventures into IAS 28, the Board decided that IAS 28 should be applied to the accounting for investments held by all entities that have joint control of, or significant influence over, an investee.

Significant influence

Potential voting rights

BC15 In its deliberation of the amendments to IAS 28, the Board considered whether the requirements now in paragraphs 7–9 of IAS 28 regarding potential voting rights when assessing significant influence should be changed to be consistent with the requirements developed in the consolidation project.

BC16 The Board observed that the definition of significant influence in IAS 28 (ie 'the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies') was related to the definition of control as it was defined in IAS 27. The Board had not considered the definition of significant influence when it amended IAS 28 and concluded that it would not be appropriate to change one element of significant influence in isolation. Any such consideration should be done as part of a wider review of the accounting for associates.

Application of the equity method

Temporary joint control and significant influence (2003 revision)

BCZ17 In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* the Board decided not to exempt an entity from applying the equity method for accounting for its investments in joint ventures and associates when joint control of, or significant influence over, an investee is intended to be temporary.

Severe long-term restrictions impairing ability to transfer funds to the investor (2003 revision)

BCZ18 The Board decided not to exempt an entity from applying the equity method for accounting for its investments in joint ventures or associates when severe long-term restrictions impaired a joint venture or an associate's ability to transfer funds to the investor. It did so because such circumstances may not preclude the entity's joint control of, or significant influence over, the joint venture or the associate. The Board decided that an entity should, when assessing its ability to exercise joint control of, or significant influence over, an investee, consider restrictions on the transfer of funds from the joint venture or from the associate to the entity. In themselves, such restrictions do not preclude the existence of joint control or significant influence.

Non-coterminous year-ends (2003 revision)

BCZ19 The exposure draft that preceded the revision of IAS 28 in 2003 proposed to limit to three months any difference between the reporting dates of an entity and its associate or its joint venture when applying the equity method. Some respondents to that exposure draft believed that it could be impracticable for the entity to prepare financial statements as of the same date when the date of the entity's financial statements and those of the associate or joint venture differ by more than three months. The Board noted that a three-month limit operates in several jurisdictions and it was concerned that a longer period, such as six months, would lead to the recognition of stale information. Therefore, it decided to retain the three-month limit.

Exemptions from applying the equity method: partial use of fair value measurement of associates

BC20 The Board received a request to clarify whether different measurement bases can be applied to portions of an investment in an associate when part of the investment is not accounted for using the equity method in accordance with paragraph 18 of IAS 28, but it is instead measured at fair value through profit or loss in accordance with IFRS 9. The Board initially deliberated this amendment to IAS 28 as part of the *Improvements to IFRSs* issued in April 2010; however, at its meeting in February 2010 the Board decided to address this issue within the joint ventures project.

BC21 The Board noted that two views exist with respect to measurement. The first view identifies all direct and indirect interests held in the associate either by the parent or through any of its subsidiaries, and then applies IAS 28 to the entire investment in the associate. In accordance with this view, there is only one investment in the associate and it should be accounted for as a single unit. The second view identifies all direct and indirect interests held in an associate, but then allows the use of the measurement exemption to portions of an investment in an associate if the portion is held by a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, regardless of whether those entities have significant influence over their portion of the investment in the associate. The Board agreed with the second view and therefore amended IAS 28. The Board decided that equivalent guidance on the partial use of fair value for the measurement of investments in joint ventures should not be provided because the Board thought that such events would be unlikely in practice.

BC22 The Board also discussed whether the partial use of fair value should be allowed only in the case of venture capital organisations, or mutual funds, unit trusts and similar entities including investment-linked insurance funds, that have designated their portion of the investment in the associate at fair value through profit or loss in their own financial statements. The Board noted that several situations might arise in which those entities do not measure their portion of the investment in the associate at fair value through profit or loss. In those situations, however, from the group's perspective, the appropriate determination of the business purpose would lead to the measurement of this portion of the investment in the associate at fair value through profit or loss in the consolidated financial statements. Consequently, the Board decided that an entity should be able to measure a portion of an investment in an associate held by a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, at fair value through profit or loss regardless of whether this portion of the investment is measured at fair value through profit or loss in those entities' financial statements.

Classification as held for sale

BC23 ED 9 proposed that an entity should account for an interest in a joint venture that is classified as held for sale in accordance with IFRS 5.

BC24 During its redeliberation of ED 9 the Board noted that the exposure draft *Improvements to IFRSs* published in August 2009 had proposed to amend IFRS 5 so as to require an entity to classify as held for sale its interest in an associate, or in a jointly controlled entity, when it is committed to a sale plan involving loss of significant influence or loss of joint control. Those proposals aimed to clarify that all the interest ('the whole interest') an entity had in an associate or a joint venture had to be classified as held for sale if the entity was committed to a sale plan involving loss of, significant influence over, or joint control of that interest.

BC25 The Board observed that those proposals were not aligned with the decisions made during the Board's redeliberation of ED 9 to remove all descriptions that associated the loss of joint control and the loss of significant influence with the term 'significant economic event' as introduced in the second phase of the Board's project on business combinations (see paragraphs BC28–BC31).

BC26 The Board decided that classifying an interest as held for sale should be on the basis of whether the intended disposal meets the criteria for classification as held for sale in accordance with IFRS 5, rather than on whether the entity had lost joint control of, or significant influence over, that interest. As a result, the Board concluded that when the disposal of an interest, or a portion of an interest, in a joint venture or an associate fulfilled the criteria for classification as held for sale in accordance with IFRS 5, an entity should classify the whole interest, or a portion of the interest, as held for sale.

BC27 The Board decided that, in the case of a partial disposal, an entity should maintain the use of the equity method for the retained interest in the joint venture or associate until the portion classified as held for sale is finally disposed of. The Board reasoned that even if the entity has the intention of selling a portion of an interest in an associate or a joint venture, until it does so it still has significant influence over, or joint control of, that investee. After the disposal, an entity should measure the retained interest in the joint venture or associate in accordance with IFRS 9 or in accordance with IAS 28 if the entity still has significant influence over, or joint control of, the retained interest.

Discontinuing the use of the equity method

BC28 During its redeliberation of ED 9, the Board reconsidered whether its decision in the second phase of the business combinations project to characterise loss of joint control or loss of significant influence as a significant economic event (ie in the same way that loss of control is characterised as a significant economic event) was appropriate. If it were, the Board thought that the entity should be required to recalibrate the accounting as required by IFRS 10. However, the Board concluded that, although significant, the events are fundamentally different. In the case of loss of control, the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost the composition of the group is unaffected.

BC29 The Board also noted that retaining the characterisation of significant economic event in the case of loss of joint control or significant influence when the retained interest is a financial asset is unnecessary. IFRS 9 already requires that in such cases the retained interest (ie a financial asset) must be measured at fair value.

BC30 In the case of loss of joint control when significant influence is maintained, the Board acknowledged that the investor-investee relationship changes and, consequently, so does the nature of the investment. However, in this instance, both investments (ie the joint venture and the associate) continue to be measured using the equity method. Considering that there is neither a change in the group boundaries nor a change in the measurement requirements, the Board concluded that losing joint control and retaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.

BC31 Consequently, the Board removed all descriptions that characterise loss of joint control or significant influence as a significant economic event as introduced in the second phase of the Board's project on business combinations.

Incorporation of SIC-13

BC32 In the joint ventures project, the Board decided to extend the requirements and guidance in IAS 28 for the accounting for 'downstream' and 'upstream' transactions between an entity and its associate to the accounting for transactions between an entity and its joint venture.

BC33 In ED 9, the Board proposed to incorporate into the standard on joint arrangements the consensus of SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*. Because the Board relocated all the requirements for the accounting for joint ventures into IAS 28, the Board incorporated the consensus of SIC-13 into IAS 28 and extended it to associates.

BC34 The Board noted that the consensus of SIC-13 regarding non-monetary contributions made by a venturer* to a joint venture is consistent with IAS 28, except for the following aspect. SIC-13 established three exceptions for the recognition of gains or losses attributable to the equity interests of the other parties. In response to comments raised by some respondents to ED 9, the Board redeliberated the need to incorporate into IAS 28 the exceptions included in SIC-13 for the recognition by an entity of the portion of a gain or loss attributable to the interests of other unrelated investors in the investee.

BC35 The Board concluded that only when the transaction lacks commercial substance should there be an exception for the recognition of gains or losses to be carried forward from the consensus of SIC-13 into IAS 28, because the other two exceptions in SIC-13 (ie 'the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the jointly controlled entity' and 'the gain or loss on the non-monetary contribution cannot be measured reliably') either relate to requirements that are not aligned with the principles and requirements of IFRS 11 or relate to a criterion for the recognition of gain or losses (ie 'reliability of measurement') that is already included in the *Conceptual Framework for Financial Reporting*.

* IFRS 11 *Joint Arrangements*, issued in May 2011, uses the term 'joint venturers' to designate parties that have joint control of a joint venture.

BCZ36 To the extent that the entity also receives monetary or non-monetary assets dissimilar to the assets contributed in addition to equity interests in the investee, the realisation of which is not dependent on the future cash flows of the investee, the earnings process is complete. Accordingly, an entity should recognise in full in profit or loss the portion of the gain or loss on the non-monetary contribution relating to the monetary or non-monetary assets received.

BC37 Additionally, the Board considered whether the requirements in IAS 31 for recognition of losses when downstream or upstream transactions provide evidence of a reduction in the net realisable value or impairment loss of the assets transacted or contributed were still relevant and decided to bring them forward to IAS 28.

Recognition of losses (2003 revision)

BCZ38 The 2000 version of IAS 28 and SIC-20 *Equity Accounting Method—Recognition of Losses* restricted application of the equity method when, in accounting for the entity's share of losses, the carrying amount of the investment is reduced to zero.

BCZ39 The Board decided that the base to be reduced to zero should be broader than residual equity interests and should also include other non-equity interests that are in substance part of the net investment in the associate or joint venture, such as long-term receivables. Therefore, the Board decided to withdraw SIC-20.

BCZ40 The Board also noted that if non-equity investments are not included in the base to be reduced to zero, an entity could restructure its investment to fund the majority in non-equity investments to avoid recognising the losses of the associate or joint venture under the equity method.

BCZ41 In widening the base against which losses are to be recognised, the Board also clarified the application of the impairment provisions of IAS 39 *Financial Instruments: Recognition and Measurement* to the financial assets that form part of the net investment.

Impairment losses (2008 amendment)

BCZ42 In 2008 the Board identified unclear guidance in IAS 28 regarding the extent to which an impairment reversal should be recognised as an adjustment to the carrying amount of an investment in an associate or in a joint venture.

BCZ43 The Board noted that applying the equity method involves adjusting the entity's share of the impairment loss recognised by the associate or joint venture on assets such as goodwill or property, plant and equipment to take account of the acquisition date fair values of those assets. The Board proposed in the exposure draft *Improvements to International Financial Reporting Standards* published in October 2007 that an additional impairment recognised by the entity, after applying the equity method, should not be allocated to any asset, including goodwill, that forms part of the carrying amount of the investment. Therefore, such an impairment should be reversed in a subsequent period to the extent that the recoverable amount of the investment increases.

BCZ44 Some respondents to the exposure draft expressed the view that the proposed amendment was not consistent with IAS 39 (regarding reversal of an impairment loss on an available-for-sale equity instrument), or with IAS 36 *Impairment of Assets* (regarding the allocation of an impairment loss to goodwill and any reversal of an impairment loss relating to goodwill).

BCZ45 In its redeliberations, the Board affirmed its previous decisions but, in response to the comments made, decided to clarify the reasons for the amendments. The Board decided that an entity should not allocate an impairment loss to any asset that forms part of the carrying amount of the investment in the associate or joint venture because the investment is the only asset that the entity controls and recognises.

BCZ46 The Board also decided that any reversal of this impairment loss should be recognised as an adjustment to the investment in the associate or joint venture to the extent that the recoverable amount of the investment increases. This requirement is consistent with IAS 36, which permits the reversal of impairment losses for assets other than goodwill. The Board did not propose to align the requirements for the reversal of an impairment loss with those in IAS 39 relating to equity instruments, because an entity recognises an impairment loss on an investment in an associate or joint venture in accordance with IAS 36, rather than in accordance with IAS 39.

Effective date and transition

BC47 The Board decided to align the effective date for the Standard with the effective date for IFRS 10, IFRS 11, IFRS 12 *Disclosure of Interests in Other Entities* and IAS 27 *Separate Financial Statements*. When making this decision, the Board noted that the five IFRSs all deal with the assessment of, and related accounting and disclosure requirements about, a reporting entity's special relationships with other entities (ie when the reporting entity has control or joint control of, or significant influence over, another entity). As a result, the Board concluded that applying IAS 28 without also applying the other four IFRSs could cause unwarranted confusion.

BC48 The Board usually sets an effective date of between twelve and eighteen months after issuing an IFRS. When deciding the effective date for those IFRSs, the Board considered the following factors:

(a) the time that many countries require for translation and for introducing the mandatory requirements into law.

(b) the consolidation project was related to the global financial crisis that started in 2007 and was accelerated by the Board in response to urgent requests from the leaders of the G20, the Financial Stability Board, users of financial statements, regulators and others to improve the accounting and disclosure of an entity's 'off balance sheet' activities.

(c) the comments received from respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 regarding implementation costs, effective date and transition requirements of the IFRSs to be issued in 2011. Most respondents did not identify the consolidation and joint arrangements IFRSs as having a high impact in terms of the time and resources that their implementation would require. In addition, only a few respondents commented that the effective dates of those IFRSs should be aligned with those of the other IFRSs to be issued in 2011.

BC49 With those factors in mind, the Board decided to require entities to apply the five IFRSs for annual periods beginning on or after 1 January 2013.

BC50 Most respondents to the Request for Views supported early application of the IFRSs to be issued in 2011. Respondents stressed that early application was especially important for first-time adopters in 2011 and 2012. The Board was persuaded by these arguments and decided to permit early application of IAS 28 but only if an entity applies it in conjunction with the other IFRSs (ie IFRS 10, IFRS 11, IFRS 12 and IAS 27 (as amended in 2011)) to avoid a lack of comparability among financial statements, and for the reasons noted in paragraph BC47 that triggered the Board's decision to set the same effective date for all five IFRSs. Even though an entity should apply the five IFRSs at the same time, the Board noted that an entity should not be prevented from providing any information required by IFRS 12 early if by doing so users gained a better understanding of the entity's relationships with other entities.

General

Withdrawal of IAS 28 (2003 revision)

BC51 IAS 28 *Investments in Associates and Joint Ventures* replaces IAS 28 *Investments in Associates* (as revised in 2003 and amended in 2010). IAS 28 (as amended in 2011) incorporates the accounting for joint ventures and includes some amendments discussed by the Board during its redeliberation of the exposure draft ED 9.

Disclosure

BC52 IAS 28 does not address the disclosure requirements for entities with joint control of, or significant influence over, an investee. As part of its redeliberation of ED 9 and ED 10 *Consolidated Financial Statements*, the Board identified an opportunity to integrate and make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities, and to present those requirements in a single IFRS.

BC53 The Board observed that IAS 27, IAS 28 and IAS 31 contained many similar disclosure requirements. ED 9 had already proposed amendments to the disclosure requirements for joint ventures and associates to align the disclosure requirements for those two types of investments more closely. The Board noted that the majority of respondents agreed with the proposals in ED 9 to align the disclosures for joint ventures with the disclosures in IAS 28 for associates.

BC54 As a result, the Board combined the disclosure requirements for interest with subsidiaries, joint arrangements, associates and unconsolidated structured entities within a single comprehensive standard, IFRS 12.

BC55 The Basis for Conclusions accompanying IFRS 12 summarises the Board's considerations in developing that IFRS, including its review of responses to the disclosure proposals in ED 9. Accordingly, IAS 28 does not include disclosure requirements and this Basis for Conclusions does not incorporate the Board's considerations of responses to the proposed disclosure requirements in ED 9.

Summary of main changes from IAS 28 (2003 revision)

BC56 The main changes from the previous version of IAS 28 are as follows:

(a) The accounting for joint ventures has been incorporated into the Standard.

(b) The scope exception for venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds has been eliminated and has been characterised as a measurement exemption from the requirement to measure investments in associates and joint ventures in using the equity method.

(c) IAS 28 now permits an entity that has an investment in an associate, a portion of which is held indirectly through venture capital organisations, or mutual funds, unit trusts and similar entities including investment-linked insurance funds, to elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with IFRS 9 regardless of whether these entities have significant influence over that portion of the investment.

(d) IAS 28 requires a portion of an investment in an associate or a joint venture to be classified as held for sale if the disposal of that portion of the interest would fulfil the criteria to be classified as held for sale in accordance with IFRS 5.

(e) The consensus of SIC-13 has been incorporated into IAS 28. As a result, gains and losses resulting from a contribution of a non-monetary asset to an associate or a joint venture in exchange for an equity interest in an associate or a joint venture are recognised only to the extent of unrelated investors' interests in the associate or joint venture, except when the contribution lacks commercial substance, as that term is described in IAS 16 *Property, Plant and Equipment*.

(f) The disclosure requirements have been placed in IFRS 12.

Dissenting opinion on amendment issued in May 2008

Dissent of Tatsumi Yamada

DO1 Mr Yamada voted against one of the amendments to IAS 28 *Investments in Associates* issued in *Improvements to IFRSs* in May 2008.

DO2 Mr Yamada believes it is inappropriate not to allocate any additional impairment losses to the goodwill and other assets that form part of the carrying amount of the investment in the associate. In his view, because he believes that an investor can identify attributable goodwill when it makes an investment, all impairment losses recognised with respect to the investor's investment in an associate should be allocated to the goodwill and other assets that form part of the carrying amount of the investment.

DO3 Mr Yamada also believes that all impairment losses allocated to goodwill should not be subsequently reversed. In his view the non-allocation of impairment losses to goodwill as required by the amendment and the subsequent reversal of such impairment losses in substance leads to the recognition of internally generated goodwill. He believes that the amendment to IAS 28 is not consistent with paragraphs 124 and 125 of IAS 36 *Impairment of Assets*, which prohibit the reversal of impairment losses related to goodwill.

Table of Concordance

This table shows how the contents of the superseded version of HKAS 28 (issued in 2004) and the amended version of HKAS 28 in 2011 correspond. Some requirements in the superseded version of HKAS 28 were incorporated into HKFRS 12 *Disclosure of Interests in Other Entities*; this table also shows how those paragraphs correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Superseded HKAS 28 paragraph	**Amended HKAS 28 paragraph**	**HKFRS 12 paragraph**	**Amended HKAS 27 paragraph**
1	2, 18, 19		
2	3, 4		
3			7
4			6
5			8
6	5		
7	6		
8	7		
9	8		
10	9		
11	10		
12	12		
13	17		
14	20		
15	21		
17	11		
18	22		
19	22		
19A	23		
20	26		
21	27		
22	28		
23	32		
24	33		
25	34		

26	35		
27	36		
28	37		
29	38		
30	39		
31	40		
32	41		
33	42		
34	43		
35	44		
36			3
37		21–24	
38		21–24	
39		21–24	
40		21–24	
41	45		
41A–41E			
42	47		
43	47		
None	1, 13–16, 24, 25, 29–31, 46		

HKAS 31
Revised ~~May 2010~~June 2011

Effective for annual periods
beginning on or after 1 January 2005*

Hong Kong Accounting Standard 31

Interests in Joint Ventures

An entity shall apply amendments resulting from *Improvements to HKFRSs* issued in May 2010 for annual periods beginning on or after 1 July 2010.

*HKAS 31 is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2013. HKFRS 11 *Joint Arrangements* issued in June 2011 is applicable for annual periods beginning on or after 1 January 2013 and supersedes HKAS 31.

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HKFRS 10
Issued June 2011

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 10

Consolidated Financial Statements

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

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BASIS FOR CONCLUSIONS *(see separate booklet)*

APPENDIX

Amendments to the Basis for Conclusions on other HKFRSs

AMENDMENTS TO THE GUIDANCE ON OTHER HKFRSs

Hong Kong Financial Reporting Standard 10 *Consolidated Financial Statements* (HKFRS 10) is set out in paragraphs 1–26 and Appendices A–D. 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 Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 10 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting.* HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 HKFRS 10 *Consolidated Financial Statements* establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

IN2 The HKFRS supersedes HKAS 27 (Revised) *Consolidated and Separate Financial Statements* and HK(SIC)-Int 12 *Consolidation—Special Purpose Entities* and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Reasons for issuing the HKFRS

IN3 The International Accounting Standards Board added a project on consolidation to its agenda to deal with divergence in practice in applying IAS 27 and SIC-12 (that is, the international equivalent of HKAS 27 and HK(SIC)-Int 12). For example, entities varied in their application of the control concept in circumstances in which a reporting entity controls another entity but holds less than a majority of the voting rights of the entity, and in circumstances involving agency relationships.

IN4 In addition, a perceived conflict of emphasis between IAS 27 and SIC-12 had led to inconsistent application of the concept of control. IAS 27 required the consolidation of entities that are controlled by a reporting entity, and it defined control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. SIC-12, which interpreted the requirements of IAS 27 in the context of special purpose entities, placed greater emphasis on risks and rewards.

IN5 The global financial crisis that started in 2007 highlighted the lack of transparency about the risks to which investors were exposed from their involvement with 'off balance sheet vehicles' (such as securitisation vehicles), including those that they had set up or sponsored. As a result, the G20 leaders, the Financial Stability Board and others asked the IASB to review the accounting and disclosure requirements for such 'off balance sheet vehicles'.

Main features of the HKFRS

IN6 The HKFRS requires an entity that is a parent to present consolidated financial statements. A limited exemption is available to some entities.

General requirements

IN7 The HKFRS defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. The HKFRS also sets out the accounting requirements for the preparation of consolidated financial statements.

IN8 An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Thus, the principle of control sets out the following three elements of control:

(a) power over the investee;

(b) exposure, or rights, to variable returns from involvement with the investee; and

(c) the ability to use power over the investee to affect the amount of the investor's returns.

IN9 The HKFRS sets out requirements on how to apply the control principle:

(a) in circumstances when voting rights or similar rights give an investor power, including situations where the investor holds less than a majority of voting rights and in circumstances involving potential voting rights.

(b) in circumstances when an investee is designed so that voting rights are not the dominant factor in deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

(c) in circumstances involving agency relationships.

(d) in circumstances when the investor has control over specified assets of an investee.

IN10 The HKFRS requires an investor to reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

IN11 When preparing consolidated financial statements, an entity must use uniform accounting policies for reporting like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated. Non-controlling interests in subsidiaries must be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

IN12 The disclosure requirements for interests in subsidiaries are specified in HKFRS 12 *Disclosure of Interests in Other Entities*.

Hong Kong Financial Reporting Standard 10 *Consolidated Financial Statements*

Objective

1 The objective of this HKFRS is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Meeting the objective

2 To meet the objective in paragraph 1, this HKFRS:

(a) requires an entity (the *parent*) that controls one or more other entities (*subsidiaries*) to present consolidated financial statements;

(b) defines the principle of *control*, and establishes control as the basis for consolidation;

(c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee; and

(d) sets out the accounting requirements for the preparation of consolidated financial statements.

3 This HKFRS does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination (see HKFRS 3 *Business Combinations*).

Scope

4 An entity that is a parent shall present consolidated financial statements. This HKFRS applies to all entities, except as follows:

(a) a parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with HKFRSs or International Financial Reporting Standards.

(b) post-employment benefit plans or other long-term employee benefit plans to which HKAS 19 *Employee Benefits* applies.

Control

5 **An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.**

6 **An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.**

7 **Thus, an investor controls an investee if and only if the investor has all the following:**

(a) power over the investee (see paragraphs 10–14);

(b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and

(c) the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18).

8 An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).

9 Two or more investors collectively control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the co-operation of the others, no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with the relevant HKFRSs, such as HKFRS 11 *Joint Arrangements*, HKAS 28 *Investments in Associates and Joint Ventures* or HKFRS 9 *Financial Instruments.*

Power

10 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee's returns.

11 Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements.

12 An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

13 If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

14 An investor can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has *significant influence*. However, an investor that holds only protective rights does not have power over an investee (see paragraphs B26–B28), and consequently does not control the investee.

Returns

15 An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

16 Although only one investor can control an investee, more than one party can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

Link between power and returns

17 An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

18 Thus, an investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent in accordance with paragraphs B58–B72 does not control an investee when it exercises decision-making rights delegated to it.

Accounting requirements

19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

20 Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.

21 Paragraphs B86–B93 set out guidance for the preparation of consolidated financial statements.

Non-controlling interests

22 A parent shall present non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

23 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

24 Paragraphs B94–B96 set out guidance for the accounting for non-controlling interests in consolidated financial statements.

Loss of control

25 If a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position.

(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant HKFRSs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with HKFRS 9 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.

26 Paragraphs B97–B99 set out guidance for the accounting for the loss of control.

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

consolidated financial statements	The financial statements of a **group** in which the assets, liabilities, equity, income, expenses and cash flows of the **parent** and its **subsidiaries** are presented as those of a single economic entity.
control of an investee	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
decision maker	An entity with decision-making rights that is either a principal or an agent for other parties.
group	A **parent** and its **subsidiaries**.
non-controlling interest	Equity in a **subsidiary** not attributable, directly or indirectly, to a **parent**.
parent	An entity that **controls** one or more entities.
power	Existing rights that give the current ability to direct the **relevant activities**.
protective rights	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
relevant activities	For the purpose of this HKFRS, relevant activities are activities of the investee that significantly affect the investee's returns.
removal rights	Rights to deprive the decision maker of its decision-making authority.
subsidiary	An entity that is controlled by another entity.

The following terms are defined in HKFRS 11, HKFRS 12 *Disclosure of Interests in Other Entities*, HKAS 28 (as amended in 2011) or HKAS 24 *Related Party Disclosures* and are used in this HKFRS with the meanings specified in those HKFRSs:

- associate
- interest in another entity
- joint venture
- key management personnel
- related party
- significant influence.

Appendix B
Application guidance

This appendix is an integral part of the HKFRS. It describes the application of paragraphs 1–26 and has the same authority as the other parts of the HKFRS.

B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying HKFRS 10.

Assessing control

B2 To determine whether it controls an investee an investor shall assess whether it has all the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

B3 Consideration of the following factors may assist in making that determination:

(a) the purpose and design of the investee (see paragraphs B5–B8);

(b) what the relevant activities are and how decisions about those activities are made (see paragraphs B11–B13);

(c) whether the rights of the investor give it the current ability to direct the relevant activities (see paragraphs B14–B54);

(d) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee (see paragraphs B55–B57); and

(e) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs B58–B72).

B4 When assessing control of an investee, an investor shall consider the nature of its relationship with other parties (see paragraphs B73–B75).

Purpose and design of an investee

B5 When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.

B6 When an investee's purpose and design are considered, it may be clear that an investee is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares in the investee. In this case, in the absence of any additional arrangements that alter decision-making, the assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the investee's operating and financing policies (see paragraphs B34–B50). In the most straightforward case, the investor that holds a majority of those voting rights, in the absence of any other factors, controls the investee.

B7 To determine whether an investor controls an investee in more complex cases, it may be necessary to consider some or all of the other factors in paragraph B3.

B8 An investee may be designed so that voting rights are not the dominant factor in deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. In such cases, an investor's consideration of the purpose and design of the investee shall also include consideration of the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved with the investee and whether the investor is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.

Power

B9 To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs B22–B28).

B10 The determination about whether an investor has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights the investor and other parties have in relation to the investee.

Relevant activities and direction of relevant activities

B11 For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

(a) selling and purchasing of goods or services;

(b) managing financial assets during their life (including upon default);

(c) selecting, acquiring or disposing of assets;

(d) researching and developing new products or processes; and

(e) determining a funding structure or obtaining funding.

B12 Examples of decisions about relevant activities include but are not limited to:

(a) establishing operating and capital decisions of the investee, including budgets; and

(b) appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment.

B13 In some situations, activities both before and after a particular set of circumstances arises or event occurs may be relevant activities. When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision-making rights (see paragraph 13). The investors shall reconsider this assessment over time if relevant facts or circumstances change.

Application examples

Example 1

Two investors form an investee to develop and market a medical product. One investor is responsible for developing and obtaining regulatory approval of the medical product—that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, the other investor will manufacture and market it—this investor has the unilateral ability to make all decisions about the manufacture and marketing of the project. If all the activities—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, each investor needs to determine whether it is able to direct the activities that *most* significantly affect the investee's returns. Accordingly, each investor needs to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that *most* significantly affects the investee's returns and whether it is able to direct that activity. In determining which investor has power, the investors would consider:

(a) the purpose and design of the investee;

(b) the factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product;

(c) the effect on the investee's returns resulting from each investor's decision-making authority with respect to the factors in (b); and

(d) the investors' exposure to variability of returns.

In this particular example, the investors would also consider:

(e) the uncertainty of, and effort required in, obtaining regulatory approval (considering the investor's record of successfully developing and obtaining regulatory approval of medical products); and

(f) which investor controls the medical product once the development phase is successful.

continued…

…continued

Application examples

Example 2

An investment vehicle (the investee) is created and financed with a debt instrument held by an investor (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 per cent of the equity is also the asset manager. The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investee. The returns of the investee are significantly affected by the management of the investee's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investee's asset portfolio is the relevant activity of the investee. The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value. The asset manager and the debt investor each need to determine whether they are able to direct the activities that *most* significantly affect the investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

Rights that give an investor power over an investee

B14 Power arises from rights. To have power over an investee, an investor must have existing rights that give the investor the current ability to direct the relevant activities. The rights that may give an investor power can differ between investees.

B15 Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

(a) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B34–B50);

(b) rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;

(c) rights to appoint or remove another entity that directs the relevant activities;

(d) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and

(e) other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

B16 Generally, when an investee has a range of operating and financing activities that significantly affect the investee's returns and when substantive decision-making with respect to these activities is required continuously, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements.

B17 When voting rights cannot have a significant effect on an investee's returns, such as when voting rights relate to administrative tasks only and contractual arrangements determine the direction of the relevant activities, the investor needs to assess those contractual arrangements in order to determine whether it has rights sufficient to give it power over the investee. To determine whether an investor has rights sufficient to give it power, the investor shall consider the purpose and design of the investee (see paragraphs B5–B8) and the requirements in paragraphs B51–B54 together with paragraphs B18–B20.

B18 In some circumstances it may be difficult to determine whether an investor's rights are sufficient to give it power over an investee. In such cases, to enable the assessment of power to be made, the investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Consideration is given, but is not limited, to the following, which, when considered together with its rights and the indicators in paragraphs B19 and B20, may provide evidence that the investor's rights are sufficient to give it power over the investee:

(a) The investor can, without having the contractual right to do so, appoint or approve the investee's key management personnel who have the ability to direct the relevant activities.

(b) The investor can, without having the contractual right to do so, direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor.

(c) The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.

(d) The investee's key management personnel are related parties of the investor (for example, the chief executive officer of the investee and the chief executive officer of the investor are the same person).

(e) The majority of the members of the investee's governing body are related parties of the investor.

B19 Sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the following suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power:

(a) The investee's key management personnel who have the ability to direct the relevant activities are current or previous employees of the investor.

(b) The investee's operations are dependent on the investor, such as in the following situations:

(i) The investee depends on the investor to fund a significant portion of its operations.

(ii) The investor guarantees a significant portion of the investee's obligations.

(iii) The investee depends on the investor for critical services, technology, supplies or raw materials.

(iv) The investor controls assets such as licences or trademarks that are critical to the investee's operations.

(v) The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.

(c) A significant portion of the investee's activities either involve or are conducted on behalf of the investor.

(d) The investor's exposure, or rights, to returns from its involvement with the investee is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee.

B20 The greater an investor's exposure, or rights, to variability of returns from its involvement with an investee, the greater is the incentive for the investor to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of returns is an indicator that the investor may have power. However, the extent of the investor's exposure does not, in itself, determine whether an investor has power over the investee.

B21 When the factors set out in paragraph B18 and the indicators set out in paragraphs B19 and B20 are considered together with an investor's rights, greater weight shall be given to the evidence of power described in paragraph B18.

Substantive rights

B22 An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise that right.

B23 Determining whether rights are substantive requires judgement, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:

(a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:

(i) financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.

(ii) an exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.

(iii) terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.

(iv) the absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that would allow the holder to exercise its rights.

(v) the inability of the holder of the rights to obtain the information necessary to exercise its rights.

(vi) operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (eg the absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the incumbent manager).

(vii) legal or regulatory requirements that prevent the holder from exercising its rights (eg where a foreign investor is prohibited from exercising its rights).

(b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive. However, a board of directors whose members are independent of the decision maker may serve as a mechanism for numerous investors to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors are more likely to be substantive than if the same rights were exercisable individually by a large number of investors.

(c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in an investee (see paragraphs B47–B50) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the investor would benefit for other reasons (eg by realising synergies between the investor and the investee) from the exercise or conversion of the instrument.

B24 To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

Application examples

Example 3

The investee has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.

The above fact pattern applies to examples 3A–3D described below. Each example is considered in isolation.

Example 3A

An investor holds a majority of the voting rights in the investee. The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding.

Example 3B

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the investor has rights that are essentially equivalent to the majority shareholder in example 3A above (ie the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

Example 3C

An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 3B.

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Application examples

Example 3D

An investor is party to a forward contract to acquire the majority of shares in the investee, with no other related rights over the investee. The forward contract's settlement date is in six months. In contrast to the examples above, the investor does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

B25 Substantive rights exercisable by other parties can prevent an investor from controlling the investee to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions. As long as the rights are not merely protective (see paragraphs B26–B28), substantive rights held by other parties may prevent the investor from controlling the investee even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Protective rights

B26 In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective (see paragraphs B13 and B53).

B27 Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee (see paragraph 14).

B28 Examples of protective rights include but are not limited to:

(a) a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.

(b) the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.

(c) the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

Franchises

B29 A franchise agreement for which the investee is the franchisee often gives the franchisor rights that are designed to protect the franchise brand. Franchise agreements typically give franchisors some decision-making rights with respect to the operations of the franchisee.

B30 Generally, franchisors' rights do not restrict the ability of parties other than the franchisor to make decisions that have a significant effect on the franchisee's returns. Nor do the rights of the franchisor in franchise agreements necessarily give the franchisor the current ability to direct the activities that significantly affect the franchisee's returns.

B31 It is necessary to distinguish between having the current ability to make decisions that significantly affect the franchisee's returns and having the ability to make decisions that protect the franchise brand. The franchisor does not have power over the franchisee if other parties have existing rights that give them the current ability to direct the relevant activities of the franchisee.

B32 By entering into the franchise agreement the franchisee has made a unilateral decision to operate its business in accordance with the terms of the franchise agreement, but for its own account.

B33 Control over such fundamental decisions as the legal form of the franchisee and its funding structure may be determined by parties other than the franchisor and may significantly affect the returns of the franchisee. The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor has only protective rights.

Voting rights

B34 Often an investor has the current ability, through voting or similar rights, to direct the relevant activities. An investor considers the requirements in this section (paragraphs B35–B50) if the relevant activities of an investee are directed through voting rights.

Power with a majority of the voting rights

B35 An investor that holds more than half of the voting rights of an investee has power in the following situations, unless paragraph B36 or paragraph B37 applies:

(a) the relevant activities are directed by a vote of the holder of the majority of the voting rights, or

(b) a majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

Majority of the voting rights but no power

B36 For an investor that holds more than half of the voting rights of an investee, to have power over an investee, the investor's voting rights must be substantive, in accordance with paragraphs B22–B25, and must provide the investor with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the investor, the investor does not have power over the investee.

B37 An investor does not have power over an investee, even though the investor holds the majority of the voting rights in the investee, when those voting rights are not substantive. For example, an investor that has more than half of the voting rights in an investee cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power without a majority of the voting rights

B38 An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through:

(a) a contractual arrangement between the investor and other vote holders (see paragraph B39);

(b) rights arising from other contractual arrangements (see paragraph B40);

(c) the investor's voting rights (see paragraphs B41–B45);

(d) potential voting rights (see paragraphs B47–B50); or

(e) a combination of (a)–(d).

Contractual arrangement with other vote holders

B39 A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor does not have voting rights sufficient to give it power without the contractual arrangement. However, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.

Rights from other contractual arrangements

B40 Other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities. For example, the rights specified in a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee's returns. However, in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.

The investor's voting rights

B41 An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to direct the relevant activities unilaterally.

B42 When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

(a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:

(i) the more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(ii) the more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(b) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B47–B50);

(c) rights arising from other contractual arrangements (see paragraph B40); and

(d) any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

B43 When the direction of relevant activities is determined by majority vote and an investor holds significantly more voting rights than any other vote holder or organised group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph 42(a)–(c) alone, that the investor has power over the investee.

Application examples

Example 4

An investor acquires 48 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

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Application examples

Example 5

Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power. However, investor A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the investee. The fact that investor A might not have exercised this right or the likelihood of investor A exercising its right to select, appoint or remove management shall not be considered when assessing whether investor A has power.

B44 In other situations, it may be clear after considering the factors listed in paragraph B42(a)–(c) alone that an investor does not have power.

Application example

Example 6

Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

B45 However, the factors listed in paragraph B42(a)–(c) alone may not be conclusive. If an investor, having considered those factors, is unclear whether it has power, it shall consider additional facts and circumstances, such as whether other shareholders are passive in nature as demonstrated by voting patterns at previous shareholders' meetings. This includes the assessment of the factors set out in paragraph B18 and the indicators in paragraphs B19 and B20. The fewer voting rights the investor holds, and the fewer parties that would need to act together to outvote the investor, the more reliance would be placed on the additional facts and circumstances to assess whether the investor's rights are sufficient to give it power. When the facts and circumstances in paragraphs B18–B20 are considered together with the investor's rights, greater weight shall be given to the evidence of power in paragraph B18 than to the indicators of power in paragraphs B19 and B20.

Application examples

Example 7

An investor holds 45 per cent of the voting rights of an investee. Eleven other shareholders each hold 5 per cent of the voting rights of the investee. None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. In this case, the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power over the investee. Additional facts and circumstances that may provide evidence that the investor has, or does not have, power shall be considered.

Example 8

An investor holds 35 per cent of the voting rights of an investee. Three other shareholders each hold 5 per cent of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings—75 per cent of the voting rights of the investee have been cast at recent relevant shareholders' meetings. In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

B46 If it is not clear, having considered the factors listed in paragraph B42(a)–(d), that the investor has power, the investor does not control the investee.

Potential voting rights

B47 When assessing control, an investor considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive (see paragraphs B22–B25).

B48 When considering potential voting rights, an investor shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the investor has with the investee. This includes an assessment of the various terms and conditions of the instrument as well as the investor's apparent expectations, motives and reasons for agreeing to those terms and conditions.

B49 If the investor also has voting or other decision-making rights relating to the investee's activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.

B50 Substantive potential voting rights alone, or in combination with other rights, can give an investor the current ability to direct the relevant activities. For example, this is likely to be the case when an investor holds 40 per cent of the voting rights of an investee and, in accordance with paragraph B23, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Application examples

Example 9

Investor A holds 70 per cent of the voting rights of an investee. Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of investor A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the relevant activities of the investee. In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive.

Example 10

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60 per cent of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares. Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Power when voting or similar rights do not have a significant effect on the investee's returns

B51 In assessing the purpose and design of an investee (see paragraphs B5–B8), an investor shall consider the involvement and decisions made at the investee's inception as part of its design and evaluate whether the transaction terms and features of the involvement provide the investor with rights that are sufficient to give it power. Being involved in the design of an investee alone is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.

B52 In addition, an investor shall consider contractual arrangements such as call rights, put rights and liquidation rights established at the investee's inception. When these contractual arrangements involve activities that are closely related to the investee, then these activities are, in substance, an integral part of the investee's overall activities, even though they may occur outside the legal boundaries of the investee. Therefore, explicit or implicit decision-making rights embedded in contractual arrangements that are closely related to the investee need to be considered as relevant activities when determining power over the investee.

B53 For some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective.

Application examples

Example 11

An investee's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable the investee automatically puts the receivable to an investor as agreed separately in a put agreement between the investor and the investee. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee's returns—the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors. Therefore, only the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the investee's returns. In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of the investee.

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Application examples

Example 12

The only assets of an investee are receivables. When the purpose and design of the investee are considered, it is determined that the only relevant activity is managing the receivables upon default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.

B54 An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to variability of returns and thus increase the incentive for the investor to obtain rights sufficient to give it power. Therefore a commitment to ensure that an investee operates as designed may be an indicator that the investor has power, but does not, by itself, give an investor power, nor does it prevent another party from having power.

Exposure, or rights, to variable returns from an investee

B55 When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.

B56 Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative (see paragraph 15). An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of this HKFRS because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (ie how variable those returns are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

B57 Examples of returns include:

(a) dividends, other distributions of economic benefits from an investee (eg interest from debt securities issued by the investee) and changes in the value of the investor's investment in that investee.

(b) remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee.

(c) returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

Link between power and returns

Delegated power

B58 When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority (see paragraphs 17 and 18). Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

B59 An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the investee by considering the requirements in paragraphs B5–B54. Paragraphs B60–B72 provide guidance on determining whether a decision maker is an agent or a principal.

B60 A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:

(a) the scope of its decision-making authority over the investee (paragraphs B62 and B63).

(b) the rights held by other parties (paragraphs B64–B67).

(c) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68–B70).

(d) the decision maker's exposure to variability of returns from other interests that it holds in the investee (paragraphs B71 and B72).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

B61 Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph B60 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph B65).

The scope of the decision-making authority

B62 The scope of a decision maker's decision-making authority is evaluated by considering:

(a) the activities that are permitted according to the decision-making agreement(s) and specified by law, and

(b) the discretion that the decision maker has when making decisions about those activities.

B63 A decision maker shall consider the purpose and design of the investee, the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved and the level of involvement the decision maker had in the design of an investee. For example, if a decision maker is significantly involved in the design of the investee (including in determining the scope of decision-making authority), that involvement may indicate that the decision maker had the opportunity and incentive to obtain rights that result in the decision maker having the ability to direct the relevant activities.

Rights held by other parties

B64 Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of an investee. Substantive removal or other rights may indicate that the decision maker is an agent.

B65 When a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (ie remuneration and other interests), the less the weighting that shall be placed on this factor.

B66 Substantive rights held by other parties that restrict a decision maker's discretion shall be considered in a similar manner to removal rights when evaluating whether the decision maker is an agent. For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent. (See paragraphs B22–B25 for additional guidance on rights and whether they are substantive.)

B67 Consideration of the rights held by other parties shall include an assessment of any rights exercisable by an investee's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph B23(b)).

Remuneration

B68 The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the returns expected from the activities of the investee, the more likely the decision maker is a principal.

B69 In determining whether it is a principal or an agent the decision maker shall also consider whether the following conditions exist:

(a) The remuneration of the decision maker is commensurate with the services provided.

(b) The remuneration agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.

B70 A decision maker cannot be an agent unless the conditions set out in paragraph B69(a) and (b) are present. However, meeting those conditions in isolation is not sufficient to conclude that a decision maker is an agent.

Exposure to variability of returns from other interests

B71 A decision maker that holds other interests in an investee (eg investments in the investee or provides guarantees with respect to the performance of the investee), shall consider its exposure to variability of returns from those interests in assessing whether it is an agent. Holding other interests in an investee indicates that the decision maker may be a principal.

B72 In evaluating its exposure to variability of returns from other interests in the investee a decision maker shall consider the following:

(a) the greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.

(b) whether its exposure to variability of returns is different from that of the other investors and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, an investee.

The decision maker shall evaluate its exposure relative to the total variability of returns of the investee. This evaluation is made primarily on the basis of returns expected from the activities of the investee but shall not ignore the decision maker's maximum exposure to variability of returns of the investee through other interests that the decision maker holds.

Application examples

Example 13

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10 per cent pro rata investment in the fund and receives a market-based fee for its services equal to 1 per cent of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10 per cent investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager, but can redeem their interests within particular limits set by the fund.

Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager's decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this example, consideration of the fund manager's exposure to variability of returns from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 14

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market-based fee for its services equal to 1 per cent of assets under management and 20 per cent of all the fund's profits if a specified profit level is achieved. The fees are commensurate with the services provided.

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Application examples

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of returns from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to examples 14A–14C described below. Each example is considered in isolation.

Example 14A

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

The fund manager's 2 per cent investment increases its exposure to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of returns from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 14B

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

In this example, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

continued…

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Application examples

For example, having considered its remuneration and the other factors, the fund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the fund. However, in different circumstances (ie if the remuneration or other factors are different), control may arise when the level of investment is different.

Example 14C

The fund manager has a 20 per cent pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20 per cent investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20 per cent investment together with its remuneration creates exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this example, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of returns of the fund from its remuneration and investment, the substantive rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 15

An investee is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual returns of the investee. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 10 per cent of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (ie 1 per cent of assets under management) and performance-related fees (ie 10 per cent of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity in the investee.

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Application examples

The remaining 65 per cent of the equity, and all the debt instruments, are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35 per cent of the equity and from its remuneration.

Although operating within the parameters set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns—the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its equity interest, which is subordinate to the debt instruments. Holding 35 per cent of the equity creates subordinated exposure to losses and rights to returns of the investee, which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls the investee.

Example 16

A decision maker (the sponsor) sponsors a multi-seller conduit, which issues short-term debt instruments to unrelated third party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the conduit. Each transferor services the portfolio of assets that it sells to the conduit and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralisation of the assets transferred to the conduit. The sponsor establishes the terms of the conduit and manages the operations of the conduit for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the conduit, approves the assets to be purchased by the conduit and makes decisions about the funding of the conduit. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual return of the conduit and also provides credit enhancement and liquidity facilities to the conduit. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the conduit's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

continued…

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Application examples

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of returns from the activities of the conduit because of its rights to any residual returns of the conduit and the provision of credit enhancement and liquidity facilities (ie the conduit is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the conduit, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that *most* significantly affect the conduit's returns (ie the sponsor established the terms of the conduit, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the conduit (for which new investment must be found on a regular basis)). The right to residual returns of the conduit and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of returns from the activities of the conduit that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the conduit. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

Relationship with other parties

B73 When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (ie they are 'de facto agents'). The determination of whether other parties are acting as de facto agents requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the investor.

B74 Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf. In these circumstances, the investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.

B75 The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the investor:

(a) the investor's related parties.

(b) a party that received its interest in the investee as a contribution or loan from the investor.

(c) a party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval (except for situations in which the investor and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).

(d) a party that cannot finance its operations without subordinated financial support from the investor.

(e) an investee for which the majority of the members of its governing body or for which its key management personnel are the same as those of the investor.

(f) a party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients.

Control of specified assets

B76 An investor shall consider whether it treats a portion of an investee as a deemed separate entity and, if so, whether it controls the deemed separate entity.

B77 An investor shall treat a portion of an investee as a deemed separate entity if and only if the following condition is satisfied:

> Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the returns from the specified assets can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.

B78 When the condition in paragraph B77 is satisfied, an investor shall identify the activities that significantly affect the returns of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the investee. When assessing control of the deemed separate entity, the investor shall also consider whether it has exposure or rights to variable returns from its involvement with that deemed separate entity and the ability to use its power over that portion of the investee to affect the amount of the investor's returns.

B79 If the investor controls the deemed separate entity, the investor shall consolidate that portion of the investee. In that case, other parties exclude that portion of the investee when assessing control of, and in consolidating, the investee.

Continuous assessment

B80 An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7.

B81 If there is a change in how power over an investee can be exercised, that change must be reflected in how an investor assesses its power over an investee. For example, changes to decision-making rights can mean that the relevant activities are no longer directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.

B82 An event can cause an investor to gain or lose power over an investee without the investor being involved in that event. For example, an investor can gain power over an investee because decision-making rights held by another party or parties that previously prevented the investor from controlling an investee have elapsed.

B83 An investor also considers changes affecting its exposure, or rights, to variable returns from its involvement with an investee. For example, an investor that has power over an investee can lose control of an investee if the investor ceases to be entitled to receive returns or to be exposed to obligations, because the investor would fail to satisfy paragraph 7(b) (eg if a contract to receive performance-related fees is terminated).

B84 An investor shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the investor and other parties can mean that an investor no longer acts as an agent, even though it has previously acted as an agent, and vice versa. For example, if changes to the rights of the investor, or of other parties, occur, the investor shall reconsider its status as a principal or an agent.

B85 An investor's initial assessment of control or its status as a principal or an agent would not change simply because of a change in market conditions (eg a change in the investee's returns driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed in paragraph 7 or changes the overall relationship between a principal and an agent.

Accounting requirements

Consolidation procedures

B86 Consolidated financial statements:

(a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

(b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (HKFRS 3 explains how to account for any related goodwill).

(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or 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. HKAS 12 *Income Taxes* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform accounting policies

B87 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 that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

Measurement

B88 An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the consolidated statement of comprehensive income after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

Potential voting rights

B89 When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of profit or loss and changes in equity allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph B90 applies.

B90 In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns.

B91 HKFRS 9 does not apply to interests in subsidiaries that are consolidated. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in a subsidiary, the instruments are not subject to the requirements of HKFRS 9. In all other cases, instruments containing potential voting rights in a subsidiary are accounted for in accordance with HKFRS 9.

Reporting date

B92 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

B93 If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months, and the length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.

Non-controlling interests

B94 An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

B95 If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Changes in the proportion held by non-controlling interests

B96 When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Loss of control

B97 A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

(a) They are entered into at the same time or in contemplation of each other.

(b) They form a single transaction designed to achieve an overall commercial effect.

(c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.

(d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

B98 If a parent loses control of a subsidiary, it shall:

(a) derecognise:

(i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and

(ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).

(b) recognise:

(i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;

(ii) if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and

(iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.

(c) reclassify to profit or loss, or transfer directly to retained earnings if required by other HKFRSs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph B99.

(d) recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

B99 If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

Appendix C
Effective date and transition

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

Effective date

C1 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this HKFRS earlier, it shall disclose that fact and apply HKFRS 11, HKFRS 12, HKAS 27 *Separate Financial Statements* and HKAS 28 (as amended in 2011) at the same time.

Transition

C2 An entity shall apply this HKFRS retrospectively, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs C3–C6.

C3 When applying this HKFRS for the first time, an entity is not required to make adjustments to the accounting for its involvement with either:

(a) entities that were previously consolidated in accordance with HKAS 27 *Consolidated and Separate Financial Statements* and HK(SIC)-Int 12 *Consolidation—Special Purpose Entities* and, in accordance with this HKFRS, continue to be consolidated; or

(b) entities that were previously unconsolidated in accordance with HKAS 27 and HK(SIC)-Int 12 and, in accordance with this HKFRS, continue not to be consolidated.

C4 When application of this HKFRS for the first time results in an investor consolidating an investee that was not consolidated in accordance with HKAS 27 and (HK)SIC-Int 12 the investor shall:

(a) if the investee is a business (as defined in HKFRS 3), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee on the date of initial application as if that investee had been consolidated (and thus applied acquisition accounting in accordance with HKFRS 3) from the date when the investor obtained control of that investee on the basis of the requirements of this HKFRS.

(b) if the investee is not a business (as defined in HKFRS 3), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee on the date of initial application as if that investee had been consolidated (applying the acquisition method as described in HKFRS 3 without recognising any goodwill for the investee) from the date when the investor obtained control of that investee on the basis of the requirements of this HKFRS. Any difference between the amount of assets, liabilities and non-controlling interests recognised and the previous carrying amount of the investor's involvement with the investee shall be recognised as a corresponding adjustment to the opening balance of equity.

(c) if measuring an investee's assets, liabilities and non-controlling interest in accordance with (a) or (b) is impracticable (as defined in HKAS 8), the investor shall:

(i) if the investee is a business, apply the requirements of HKFRS 3. The deemed acquisition date shall be the beginning of the earliest period for which application of HKFRS 3 is practicable, which may be the current period.

(ii) if the investee is not a business, apply the acquisition method as described in HKFRS 3 without recognising any goodwill for the investee as of the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of this paragraph is practicable, which may be the current period.

The investor shall recognise any difference between the amount of assets, liabilities and non-controlling interests recognised at the deemed acquisition date and any previously recognised amounts from its involvement as an adjustment to equity for that period. In addition, the investor shall provide comparative information and disclosures in accordance with HKAS 8.

C5 When application of this HKFRS for the first time results in an investor no longer consolidating an investee that was consolidated in accordance with HKAS 27 (as amended in 2008) and HK(SIC)-Int 12, the investor shall measure its retained interest in the investee on the date of initial application at the amount at which it would have been measured if the requirements of this HKFRS had been effective when the investor became involved with, or lost control of, the investee. If measurement of the retained interest is impracticable (as defined in HKAS 8), the investor shall apply the requirements of this HKFRS for accounting for a loss of control at the beginning of the earliest period for which application of this HKFRS is practicable, which may be the current period. The investor shall recognise any difference between the previously recognised amount of the assets, liabilities and non-controlling interest and the carrying amount of the investor's involvement with the investee as an adjustment to equity for that period. In addition, the investor shall provide comparative information and disclosures in accordance with HKAS 8.

C6 Paragraphs 23, 25, B94 and B96–B99 were amendments to HKAS 27 made in 2008 that were carried forward into HKFRS 10. Except when an entity applies paragraph C3, the entity shall apply the requirements in those paragraphs as follows:

(a) An entity shall not restate any profit or loss attribution for reporting periods before it applied the amendment in paragraph B94 for the first time.

(b) The requirements in paragraphs 23 and B96 for accounting for changes in ownership interests in a subsidiary after control is obtained do not apply to changes that occurred before an entity applied these amendments for the first time.

(c) An entity shall not restate the carrying amount of an investment in a former subsidiary if control was lost before it applied the amendments in paragraphs 25 and B97–B99 for the first time. In addition, an entity shall not recalculate any gain or loss on the loss of control of a subsidiary that occurred before the amendments in paragraphs 25 and B97–B99 were applied for the first time.

References to HKFRS 9

C7 If an entity applies this HKFRS but does not yet apply HKFRS 9, any reference in this HKFRS to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement.*

Withdrawal of other HKFRSs

C8 This HKFRS supersedes the requirements relating to consolidated financial statements in HKAS 27 (as amended in 2008).

C9 This HKFRS also supersedes HK(SIC)-Int 12 *Consolidation—Special Purpose Entities*.

Appendix D
Amendments to other HKFRSs

This appendix sets out the amendments to other HKFRSs that are a consequence of issuing this HKFRS. An entity shall apply the amendments for annual periods beginning on or after 1 January 2013. If an entity applies this HKFRS for an earlier period, it shall apply these amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

D1 Paragraph 39I is added as follows:

39I HKFRS 10 *Consolidated Financial Statements* and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 31, B7, C1, D1, D14 and D15 and added paragraph D31. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D2 In Appendix B, paragraph B7 is amended as follows:

B7 A first-time adopter shall apply the following requirements of ~~HKAS 27 (as amended in 2008)~~ HKFRS 10 prospectively from the date of transition to HKFRSs:

(a) the requirement in paragraph ~~28~~ B94 that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;

(b) the requirements in paragraphs ~~30 and 31~~ 23 and B93 for accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

(c) the requirements in paragraphs ~~34–37~~ B97–B99 for accounting for a loss of control over a subsidiary, and the related requirements of paragraph 8A of HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

However, if a first-time adopter elects to apply HKFRS 3 ~~(as revised in 2008)~~ retrospectively to past business combinations, it shall also apply ~~HKAS 27 (as amended in 2008)~~ HKFRS 10 in accordance with paragraph C1 of this HKFRS.

D3 In Appendix C, paragraph C1 is amended as follows:

C1 A first-time adopter may elect not to apply HKFRS 3 ~~(as amended in 2008)~~ retrospectively to past business combinations (business combinations that occurred before the date of transition to HKFRSs). However, if a first-time adopter restates any business combination to comply with HKFRS 3 ~~(as amended in 2008)~~, it shall restate all later business combinations and shall also apply ~~HKAS 27 (as amended in 2008)~~ HKFRS 10 from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X6, it shall restate all business combinations that occurred on 30 June 20X6 and the date of transition to HKFRSs, and it shall also apply ~~HKAS 27 (amended 2008)~~ HKFRS 10 from 30 June 20X6.

HKFRS 2 *Share-based Payment*

D4 Paragraph 63A is added as follows:

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

In Appendix A the footnote to the definition of 'share-based payment arrangement' is amended as follows:

* A 'group' is defined in ~~paragraph 4~~ Appendix A of ~~HKAS 27~~ HKFRS 10 *Consolidated ~~and Separate~~ Financial Statements* as 'a parent and ~~all~~ its subsidiaries' from the perspective of the reporting entity's ultimate parent.

HKFRS 3 *Business Combinations*

D5 Paragraph 7 is amended and paragraph 64E is added as follows:

7 The guidance in ~~HKAS 27~~ HKFRS 10 *Consolidated ~~and Separate~~ Financial Statements* shall be used to identify the acquirer—the entity that obtains *control* of another entity, ie the acquiree. If a business combination has occurred but applying the guidance in ~~HKAS 27~~ HKFRS 10 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

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

D6 Paragraph IN2 is footnoted as follows:

* The requirements for consolidated financial statements in HKAS 27 were superseded by HKFRS 10 *Consolidated Financial Statements*, issued in June 2011. Topic 810 *Consolidation* in the *FASB Accounting Standards Codification*® codified the guidance in SFAS 160.

D7 In Appendix A the definition of 'control' is deleted.

D8 In Appendix B, paragraphs B13 and B63(e) are amended as follows:

B13 The guidance in ~~HKAS 27~~ HKFRS 10 *Consolidated ~~and Separate~~ Financial Statements* shall be used to identify the acquirer—the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in ~~HKAS 27~~ HKFRS 10 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

B63 Examples of other HKFRSs that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in a business combination include:

(a) …

(e) ~~HKAS 27 (as amended in 2008)~~ HKFRS 10 provides guidance on accounting for changes in a parent's ownership interest in a subsidiary after control is obtained.

HKFRS 7 *Financial Instruments: Disclosures*

D9 Paragraph 3(a) is amended and paragraph 44O is added as follows:

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31~~ ~~*Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; in those cases, …

44O HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 3. An entity shall apply that amendment when it applies HKFRS 10 and HKFRS 11.

HKFRS 9 *Financial Instruments* (as issued in November 2009)

D10 Paragraph 8.1.2 is added as follows:

8.1.2 HKFRS 10 *Consolidated Financial Statements* and HKFRS 11 *Joint Arrangements*, issued inJune2011, amended paragraph C8 and deleted the headings above paragraph C18 and paragraphs C18–C23. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D11 In Appendix C, paragraphs C18 and C19 and the headings before paragraphs C18 and C19 are deleted and paragraph C8 is amended as follows:

C8 3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31~~ ~~*Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or IAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39 and HKFRS 9; in those cases, …

HKFRS 9 *Financial Instruments* (as issued in November 2010)

D12 Paragraph 3.2.1 is amended and paragraph 7.1.2 is added as follows:

3.2.1 In consolidated financial statements, paragraphs 3.2.2–3.2.9, B3.1.1, B3.1.2 and B3.2.1–B3.2.17 are applied at a consolidated level. Hence, an entity first consolidates all subsidiaries in accordance with ~~HKAS 27~~ HKFRS 10 *Consolidated ~~and Separate~~ Financial Statements* ~~and HK(SIC)-Int 12~~ ~~*Consolidation—Special Purpose Entities*~~ and then applies those paragraphs ~~3.2.2–3.2.9, B3.1.1, B3.1.2 and B3.2.1–B3.2.17~~ to the resulting group.

7.1.2 HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 3.2.1, B3.2.1–B3.2.3, B4.3.12(c), B5.7.15, C11 and C30 and deleted paragraphs C23—C28 and the related headings. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D13 In Appendix B, paragraphs B3.2.1–B3.2.3 and B5.7.15 are amended as follows:

In paragraph B3.2.1, '(including any SPE)' in the first box of the flow chart is deleted.

B3.2.2 The situation described in paragraph 3.2.4(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a ~~special purpose entity or~~ trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 3.2.5 and 3.2.6 are met.

B3.2.3 In applying paragraph 3.2.5, the entity could be, for example, the originator of the financial asset, or it could be a group that includes a ~~consolidated special purpose entity~~ subsidiary that has acquired the financial asset and passes on cash flows to unrelated third party investors.

B5.7.15 The following are examples of asset-specific performance risk:

(a) …

(b) a liability issued by a ~~special purpose entity (SPE)~~ structured entity with the following characteristics. The ~~(SPE)~~ entity is legally isolated so the assets in the ~~SPE~~ entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The ~~SPE~~ entity enters into no other transactions and the assets in the ~~SPE~~ entity cannot be hypothecated. Amounts are due to the ~~SPE's~~ entity's investors only if the ring-fenced assets generate cash flows. Thus, …

D14 In Appendix C, paragraphs C23 and C24 and the heading before paragraph C23 are deleted and paragraphs C11 and C30 are amended as follows:

C11 3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, …

C30 **4** **This Standard shall be applied by all entities to all types of financial instruments except:**

(a) **those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, …**

HKAS 1 *Presentation of Financial Statements*

D15 Paragraphs 4 and 123 are amended and paragraph 139H is added as follows:

4 This Standard does not apply to the structure and content of condensed interim financial statements prepared in accordance with HKAS 34 *Interim Financial Reporting*. However, paragraphs 15–35 apply to such financial statements. This Standard applies equally to all entities, including those that present consolidated financial statements in accordance with HKFRS 10 *Consolidated Financial Statements* and those that present separate financial statements ~~as defined~~ in accordance with HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*.

123 In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:

(a) …

(b) when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities; and

(c) whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue~~; and~~.

(d) ~~whether the substance of the relationship between the entity and a special purpose entity indicates that the entity controls the special purpose entity.~~

139H HKFRS 10 and HKFRS 12, issued in June 2011, amended paragraphs 4, 119, 123 and 124. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 12.

HKAS 7 *Statement of Cash Flows*

D16 The rubric and paragraph 42B are amended and paragraph 57 is added as follows:

In the rubric, 'paragraphs 1–56' is amended to 'paragraphs 1–57'.

42B Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see ~~HKAS 27~~ HKFRS 10 *Consolidated ~~and Separate~~ Financial Statements* ~~(as amended in 2008)~~). Accordingly, …

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

HKAS 21 *The Effects of Changes in Foreign Exchange Rates*

D17 Paragraph IN12 is amended as follows:

IN12 The Standard permits an entity to present its financial statements in any currency (or currencies). For this purpose, an entity could be a stand-alone entity, a parent preparing consolidated financial statements in accordance with HKFRS 10 *Consolidated Financial Statements* or a parent, an investor with joint control of, or significant influence over, an investee ~~or a venturer~~ preparing separate financial statements in accordance with HKAS 27 *~~Consolidated and~~ Separate Financial Statements*.

D18 Paragraphs 19, 45 and 46 are amended and paragraph 60F is added as follows:

19 This Standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with HKAS 27 *~~Consolidated and~~ Separate Financial Statements* to present its financial statements in any currency (or currencies). If the …

45 The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see ~~HKAS 27~~ HKFRS 10 *Consolidated Financial Statements* ~~and HKAS 31 *Interests in Joint Ventures*~~). However, …

46 When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done, ~~HKAS 27~~ HKFRS 10 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. Adjustments are made for significant changes in exchange rates up to the end of the reporting period of the reporting entity in accordance with ~~HKAS 27~~ HKFRS 10. The same …

60F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 3(b), 8, 11, 18, 19, 33, 44–46 and 48A. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 24 *Related Party Disclosures*

D19 Paragraph 3 is amended as follows:

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

In paragraph 9 the definitions of 'control', 'joint control' and 'significant influence' are deleted and a sentence is added as follows:

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

Paragraph 28A is added as follows:

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

HKAS 27 *Consolidated and Separate Financial Statements*

D20 In HKAS 27 *Consolidated and Separate Financial Statements*, the requirements relating to consolidated financial statements are deleted and moved to HKFRS 10 where appropriate. The accounting and disclosure requirements for separate financial statements remain in HKAS 27; the title is amended to *Separate Financial Statements*, the remaining paragraphs are renumbered sequentially, the scope is adjusted and other editorial changes are made. The accounting and disclosure requirements remaining in HKAS 27 (as amended in 2011) are also updated to reflect the guidance in HKFRS 10, HKFRS 11, HKFRS 12 and HKAS 28 (as amended in 2011). Details of the destination of paragraphs in HKAS 27 (as amended in 2008) are contained in the table of concordance attached to HKAS 27 (as amended in 2011).

HKAS 32 *Financial Instruments: Presentation*

D21 Paragraph 4(a) is amended and paragraph 97I is added as follows:

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39…

97I HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraphs 4(a) and AG29. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D22 In the Appendix, paragraph AG29 is amended as follows:

AG29 In consolidated financial statements, an entity presents non-controlling interests—ie the interests of other parties in the equity and income of its subsidiaries—in accordance with HKAS 1 and ~~HKAS 27~~ HKFRS 10. When …

HKAS 33 *Earnings per Share*

D23 Paragraph 4 is amended and paragraph 74B is added as follows:

4 When an entity presents both consolidated financial statements and separate financial statements prepared in accordance with HKFRS 10 *Consolidated Financial Statements* and HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*, respectively, the disclosures required by this Standard need be presented only on the basis of the consolidated information. An …

74B HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 4, 40 and A11. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 36 *Impairment of Assets*

D24 Paragraph 4(a) is amended and paragraph 140H is added as follows:

4 This Standard applies to financial assets classified as:

(a) subsidiaries, as defined in ~~HKAS 27~~ <u>HKFRS 10</u> *Consolidated ~~and Separate~~ Financial Statements*;

(b) …

140H HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraph 4, the heading above paragraph 12(h) and paragraph 12(h). An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D25 In paragraph IN4 the reference to HKAS 27 *Consolidated and Separate Financial Statements* is footnoted as follows:

* The consolidation requirements in HKAS 27 were superseded by HKFRS 10 *Consolidated Financial Statements,* issued in June 2011.

HKAS 38 *Intangible Assets*

D26 Paragraph 3(e) is amended and paragraph 130F is added as follows:

3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:

(a) …

(e) financial assets as defined in HKAS 32. The recognition and measurement of some financial assets are covered by <u>HKFRS 10 *Consolidated Financial Statements,*</u> HKAS 27 *~~Consolidated and~~ Separate Financial Statements*~~,~~ <u>and</u> HKAS 28 *Investments in Associates <u>and Joint Ventures</u>* ~~and HKAS 31 *Interests in Joint Ventures*~~.

(f) …

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

HKAS 39 *Financial Instruments: Recognition and Measurement*

D27 Paragraphs 2(a) and 15 are amended and paragraph 103P is added as follows:

2 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for ~~under~~ in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates* *and Joint Ventures* ~~and HKAS 31 *Interests in Joint Ventures*~~. However, entities shall apply this Standard to an interest in a subsidiary, associate or joint venture that according to HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ is accounted for under this Standard. …

15 In consolidated financial statements, paragraphs 16–23 and Appendix A paragraphs AG34–AG52 are applied at a consolidated level. Hence, an entity first consolidates all subsidiaries in accordance with ~~HKAS 27 and HK(SIC)-Int 12 *Consolidation—Special Purpose Entities*~~ HKFRS 10 and then applies paragraphs 16–23 and Appendix A paragraphs AG34–AG52 to the resulting group.

103P HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 2(a), 15, AG3, AG36–AG38 and AG41(a). An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D28 In Appendix A paragraphs AG36–AG38 are amended as follows:

In paragraph AG36, '(including any SPE)' in the first box of the flow chart is deleted.

AG37 The situation described in paragraph 18(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a ~~special purpose entity or~~ trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 19 and 20 are met.

AG38 In applying paragraph 19, the entity could be, for example, the originator of the financial asset, or it could be a group that includes a ~~consolidated special purpose entity~~ subsidiary that has acquired the financial asset and passes on cash flows to unrelated third party investors.

HK(IFRIC)-Int 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

D29 In the 'references', the entries for HKAS 27 and HKAS 31 are deleted, the entry for HKAS 28 is amended to 'HKAS 28 *Investments in Associates and Joint Ventures*' and entries for HKFRS 10 *Consolidated Financial Statements* and HKFRS 11 *Joint Arrangements* are added.

Paragraph 8 is amended and paragraph 14B is added as follows:

8 The contributor shall determine whether it has control~~,~~ or joint control of, or significant influence over, the fund by reference to ~~HKAS 27~~ HKFRS 10, HKFRS 11 and HKAS 28~~, HKAS 31 and HK(SIC)-Int 12~~. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.

14B HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraphs 8 and 9. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HK(IFRIC)-Int 17 *Distributions of Non-cash Assets to Owners*

D30 In the 'references', an entity for 'HKFRS 10 *Consolidated Financial Statements*' is added.

Paragraph 7 is amended and paragraph 19 is added as follows:

7 In accordance with paragraph 5, this Interpretation does not apply when an entity distributes some of its ownership interests in a subsidiary but retains control of the subsidiary. The entity making a distribution that results in the entity recognising a non-controlling interest in its subsidiary accounts for the distribution in accordance with ~~HKAS 27 (as amended in 2008)~~ HKFRS 10.

19 HKFRS 10, issued in June 2011, amended paragraph 7. An entity shall apply that amendment when it applies HKFRS 10.

Appendix E
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 10.

The International Financial Reporting Standard comparable with HKFRS 10 is IFRS 10 *Consolidated Financial Statements*.

There are no major textual differences between HKFRS 10 and IFRS 10.

HKFRS 10 BC
Issued June 2011

Basis for Conclusions on
Hong Kong Financial Reporting Standard 10

Consolidated Financial Statements

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

Basis for Conclusions on HKFRS 10 *Consolidated Financial Statements*

HKFRS 10 is based on IFRS 10 *Consolidated Financial Statements*. In approving HKFRS 10, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 10. Accordingly, there are no significant differences between HKFRS 10 and IFRS 10. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 10 referred to below generally correspond with those in HKFRS 10.

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Basis for Conclusions on IFRS 10 *Consolidated Financial Statements*

This Basis for Conclusions accompanies, but is not part of, IFRS 10.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing IFRS 10 *Consolidated Financial Statements*. Individual Board members gave greater weight to some factors than to others. Unless otherwise stated, any reference below to IAS 27 is to IAS 27 *Consolidated and Separate Financial Statements,* and to IAS 28 is to IAS 28 *Investments in Associates*.

BC2 The Board added a project on consolidation to its agenda to deal with divergence in practice in applying IAS 27 and SIC-12 *Consolidation—Special Purpose Entities*. For example, entities varied in their application of the control concept:

(a) in circumstances in which an investor controls an investee but the investor has less than a majority of the voting rights of the investee (and voting rights are clearly the basis for control).

(b) in circumstances involving special purpose entities (to which the notion of 'economic substance' in SIC-12 applied).

(c) in circumstances involving agency relationships.

(d) in circumstances involving protective rights.

BC3 IAS 27 required the consolidation of entities that are controlled by a reporting entity, and it defined control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. SIC-12, which interpreted the requirements of IAS 27 in the context of special purpose entities,* placed greater emphasis on risks and rewards. This perceived conflict of emphasis had led to inconsistent application of the concept of control. This was aggravated by a lack of clear guidance on which investees were within the scope of IAS 27 and which were within the scope of SIC-12. As a result, assessing control sometimes resulted in a quantitative assessment of whether the investor had a majority of the risks. Such tests based on sharp 'bright line' distinctions created structuring opportunities to achieve particular accounting outcomes.

BC4 The global financial crisis that started in 2007 highlighted a lack of transparency about the risks to which investors were exposed from their involvement with 'off balance sheet vehicles' (such as securitisation vehicles), including those that they had set up or sponsored. As a result, the G20 leaders, the Financial Stability Board and others asked the Board to review the accounting and disclosure requirements for such 'off balance sheet vehicles'.

* To maintain consistency with the terminology used in the original documents this Basis for Conclusions refers to 'special purpose entities (SPEs)' when discussing SIC-12 and 'structured entities' when discussing the exposure draft ED 10 *Consolidated Financial Statements* and the related deliberations and redeliberations. SIC-12 described an SPE as an entity that may be created to accomplish a narrow and well-defined objective, often created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of its governing board, trustee or management over the SPE's operations. ED 10 defined a structured entity as an entity whose activities are restricted to the extent that those activities are, in essence, not directed by voting or similar rights.

BC5 In developing IFRS 10, the Board considered the responses to ED 10 *Consolidated Financial Statements*, published in December 2008. Respondents to ED 10 pointed out that the Board and the US Financial Accounting Standards Board (FASB), in their Memorandum of Understanding, had agreed to work towards developing common standards on consolidation by 2011. Therefore, they asked the boards to discuss the consolidation project jointly to ensure that the ensuing standards contained identical, not only similar, requirements. As a result, the Board's deliberations in developing IFRS 10 were conducted jointly with the FASB from October 2009.

BC6 The FASB decided in January 2011 that it would not change the consolidation requirements in US generally accepted accounting principles (GAAP) at this time with one exception. The FASB tentatively decided that it would propose changes to the consolidation requirements relating to both variable interest entities and voting interest entities in the context of assessing whether a decision maker is a principal or an agent. Those proposals would be similar to the requirements developed jointly by the IASB and the FASB regarding the principal/agent assessment, which are included in IFRS 10.

BC7 ED 10 proposed disclosure requirements for consolidated and unconsolidated investees. In its deliberation of the responses to those proposals, the Board decided to combine the disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities within a single comprehensive standard, IFRS 12 *Disclosure of Interests in Other Entities*. The Basis for Conclusions accompanying IFRS 12 summarises the Board's considerations in developing that IFRS, including its consideration of responses to the disclosure proposals in ED 10. Accordingly, IFRS 10 does not include disclosure requirements and this Basis for Conclusions does not describe the Board's consideration of responses to the proposed disclosure requirements in ED 10.

The structure of IFRS 10 and the Board's decisions

BC8 IFRS 10 replaces the requirements and guidance in IAS 27 relating to consolidated financial statements. It also replaces SIC-12. As part of its consolidation project, the Board is examining how an investment entity accounts for its interests in subsidiaries, joint ventures and associates and what, if any, additional disclosures might be made about those interests. The Board expects to publish an exposure draft on investment entities later in 2011.

BC9 In developing IFRS 10, the Board did not reconsider all the requirements that are included in the IFRS. The scope in paragraph 4 and the accounting requirements for consolidated financial statements in paragraphs 19–25 and B86–B99 were carried forward from IAS 27 or SIC-12 to IFRS 10 without being reconsidered by the Board because their reconsideration was not part of the Board's consolidation project.

BC10 When revised in 2003, IAS 27 was accompanied by a Basis for Conclusions summarising the considerations of the Board, as constituted at the time, in reaching some of its conclusions in that Standard. That Basis for Conclusions was subsequently updated to reflect amendments to the Standard. The Board has incorporated into this Basis for Conclusions material from the Basis for Conclusions on IAS 27 that discusses matters that the Board has not reconsidered. That material is contained in paragraphs denoted by numbers with the prefix BCZ. In those paragraphs cross-references to the IFRS have been updated accordingly and minor necessary editorial changes have been made.

BC11 In order to portray the historical background of IFRS 10, the documents recording the Board's approval of the revision of IAS 27 in 2003 and the subsequent amendments are set out after this Basis for Conclusions. In addition, in 2003 and later, some Board members dissented from the revision of IAS 27 and subsequent amendments, and portions of their dissenting opinions relate to requirements that have been carried forward to IFRS 10. Those dissenting opinions are set out after the Basis for Conclusions.

Presentation of consolidated financial statements (2003 revision)

Exemption from preparing consolidated financial statements

BCZ12 Paragraph 7 of IAS 27 (as revised in 2000) required consolidated financial statements to be presented. However, paragraph 8 permitted a parent that was a wholly-owned or virtually wholly-owned subsidiary not to prepare consolidated financial statements. In 2003 the Board considered whether to withdraw or amend this exemption from the general requirement.

BCZ13 The Board decided to retain an exemption, so that entities in a group that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards, in addition to consolidated financial statements, would not be unduly burdened.

BCZ14 The Board noted that in some circumstances users can find sufficient information for their purposes about a subsidiary from either its separate financial statements or the consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can get access to, more information.

BCZ15 Having concluded that it should retain an exemption, the Board decided to modify the circumstances in which an entity would be exempt and considered the following criteria.

Unanimous agreement of the owners of the minority interests*

BCZ16 The 2002 exposure draft proposed to extend the exemption to a parent that is not wholly-owned if the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree.

BCZ17 Some respondents disagreed with this proposal, largely because of the practical difficulties in obtaining responses from all the minority shareholders. Acknowledging this argument, the Board decided that the exemption should be available to a parent that is not wholly-owned when the owners of the minority interests have been informed about, and do not object to, consolidated financial statements not being presented.

* IAS 27 (as amended in 2008) changed the term 'minority interest' to 'non-controlling interest'.

Exemption available only to non-public entities

BCZ18 The Board believed that the information needs of users of financial statements of entities whose debt or equity instruments are traded in a public market were best served when investments in subsidiaries, jointly controlled entities and associates were accounted for in accordance with IAS 27, IAS 28 and IAS 31 *Interests in Joint Ventures*.* It therefore decided that the exemption from preparing consolidated financial statements should not be available to such entities or to entities in the process of issuing instruments in a public market.

Scope of consolidated financial statements (2003 revision)

Scope exclusions

BCZ19 Paragraph 13 of IAS 27 (as revised in 2000) required a subsidiary to be excluded from consolidation when control is intended to be temporary or when the subsidiary operates under severe long-term restrictions.

Temporary control

BCZ20 In 2003 the Board considered whether to remove this scope exclusion and thereby converge with other standard-setters that had recently eliminated a similar exclusion. It decided to consider this question as part of a comprehensive standard dealing with asset disposals. It decided to retain an exemption from consolidating a subsidiary when there is evidence that the subsidiary is acquired with the intention of disposing of it within twelve months and that management is actively seeking a buyer. The Board's exposure draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations* proposed to measure and present assets held for sale in a consistent manner irrespective of whether they are held by an investor or in a subsidiary. Therefore, ED 4 proposed to eliminate the exemption from consolidation when control is intended to be temporary and it contained a draft consequential amendment to IAS 27 to achieve this.†

Severe long-term restrictions impairing ability to transfer funds to the parent

BCZ21 The Board decided to remove the exclusion of a subsidiary from consolidation when there are severe long-term restrictions that impair a subsidiary's ability to transfer funds to the parent. It did so because such circumstances may not preclude control. The Board decided that a parent, when assessing its ability to control a subsidiary, should consider restrictions on the transfer of funds from the subsidiary to the parent. In themselves, such restrictions do not preclude control.

* IAS 31 was superseded by IFRS 11 *Joint Arrangements* issued in May 2011.

† In March 2004 the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removed this scope exclusion and eliminated the exemption from consolidation when control is intended to be temporary. For further discussion see the Basis for Conclusions on IFRS 5.

Venture capital organisations, private equity entities and similar organisations*

BCZ22 The 2002 exposure draft of IAS 27 proposed to clarify that a subsidiary should not be excluded from consolidation simply because the entity is a venture capital organisation, mutual fund, unit trust or similar entity. Some respondents from the private equity industry disagreed with this proposed clarification. They argued that private equity entities should not be required to consolidate the investments they control in accordance with IAS 27; instead they should measure those investments at fair value. Those respondents gave various reasons—some based on whether control is exercised, some on the length of time that should be provided before consolidation is required and some on whether consolidation was an appropriate basis for private equity entities or the types of investments they make.

BCZ23 Some respondents also noted that the Board had decided to exclude venture capital organisations and similar entities from the scope of IAS 28 and IAS 31 when investments in associates or jointly controlled entities are measured at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.†‡ In the view of those respondents, the Board was proposing that similar assets should be accounted for in dissimilar ways.

BCZ24 The Board did not accept this reasoning. The Board noted that those issues were not specific to the private equity industry. It confirmed that a subsidiary should not be excluded from consolidation on the basis of the nature of the controlling entity. Consolidation is based on the parent's ability to control the investee, which captures both the power to control (ie the ability exists but it is not exercised) and actual control (ie the ability is exercised). Consolidation is triggered by control and should not be affected by whether management intends to hold only for the short term an investment in an entity that it controls.

BCZ25 The Board noted that the exception from the consolidation principle in IAS 27 (as revised in 2000)—when control of a subsidiary is intended to be temporary—might have been misread or interpreted loosely. Some respondents to the exposure draft had interpreted 'near future' as covering a period of up to five years. The Board decided to remove those words and to restrict the exception to subsidiaries acquired and held exclusively for disposal within twelve months, provided that management is actively seeking a buyer.§

BCZ26 The Board did not agree with respondents that it should differentiate between types of entity, or types of investment, when applying a control model of consolidation. It also did not agree that management's intentions should be a determinant of control. Even if it had wished to make such differentiations, the Board did not see how or why it would be meaningful to distinguish private equity investors from other types of entities.

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* As part of its consolidation project, the Board is examining how an investment entity accounts for its interests in subsidiaries, joint ventures and associates and what, if any, additional disclosures might be made about those interests. The Board expects to publish an exposure draft on investment entities later in 2011.

† In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. In May 2011 the Board issued IFRS 13 *Fair Value Measurement*, which contains the requirements for measuring fair value.

‡ IAS 31 was superseded by IFRS 11 *Joint Arrangements* issued in May 2011.

§ In March 2004 the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removed this scope exclusion and eliminated the exemption from consolidation when control is intended to be temporary.

BCZ27 The Board believed that the diversity of the investment portfolios of entities operating in the private equity sector was no different from portfolios held by a conglomerate, which is an industrial group made up of entities that often have diverse and unrelated interests. The Board acknowledged that financial information about an entity's different types of products and services and its operations in different geographical areas—segment information—is relevant to assessing the risks and returns of a diversified or multinational entity and may not be determinable from the aggregated data presented in the consolidated balance sheet.* The Board noted that IAS 14 *Segment Reporting* established principles for reporting segment information by entities whose equity or debt instruments are publicly traded, or any entity that discloses segment information voluntarily.†

BCZ28 The Board concluded that for investments under the control of private equity entities, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control. The Board noted that a parent can either present information about the fair value of those investments in the notes to the consolidated financial statements or prepare separate financial statements in addition to its consolidated financial statements, presenting those investments at cost or at fair value. By contrast, the Board decided that information needs of users of financial statements would not be well served if those controlling investments were measured only at fair value. This would leave the assets and liabilities of a controlled entity unreported. It is conceivable that an investment in a large, highly geared subsidiary would have only a small fair value. Reporting that value alone would prevent a user from being able to assess the financial position, results and cash flows of the group.

Control as the basis for consolidation

BC29 The Board's objective in issuing IFRS 10 is to improve the usefulness of consolidated financial statements by developing a single basis for consolidation and robust guidance for applying that basis to situations where it has proved difficult to assess control in practice and divergence has evolved (see paragraphs BC2–BC4). The basis for consolidation is control and it is applied irrespective of the nature of the investee.

BC30 Almost all respondents to ED 10 supported control as the basis for consolidation. However, some noted that it can be difficult to identify an investor that has power over investees that do not require substantive continuous decision-making. They suggested that exposure to risks and rewards should be used as a proxy for control when power is not evident. Some respondents were also concerned that applying the proposed control definition to all investees could lead to more structuring opportunities than was the case when applying the requirements in IAS 27 and SIC-12. Others did not think that ED 10 expressed with sufficient clarity the importance of risks and rewards when assessing control.

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) replaced the term 'balance sheet' with 'statement of financial position'.

† In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.

BC31 The Board confirmed its view that control should be the only basis for consolidation—an investor should consolidate an investee and present in its consolidated financial statements the investee's assets, liabilities, equity, income, expenses and cash flows, if the investor has the current ability to direct those activities of the investee that significantly affect the investee's returns and can benefit by using that ability. An investor that is exposed, or has rights, to variable returns from its involvement with an investee but does not have power over the investee so as to affect the amount of the investor's return from its involvement does not control the investee.

BC32 Control as the basis for consolidation does not mean that the consideration of risks and rewards is unimportant when assessing control of an investee. The more an investor is exposed to risks and rewards from its involvement with an investee, the greater the incentive for the investor to obtain decision-making rights that give it power. However, risks and rewards and power are not necessarily perfectly correlated. Therefore, the Board confirmed that exposure to risks and rewards (referred to in IFRS 10 as variable returns) is an *indicator of control* and an important factor to consider when assessing control, but an investor's exposure to risks and rewards alone does not determine that the investor has control over an investee.

BC33 The Board observed that to conclude that exposure to risks and rewards is anything more than an indicator of control would be inconsistent with a control model that contains both a power element and a returns element.

BC34 The Board confirmed that an investor must have exposure to risks and rewards in order to control an investee—without any exposure to risks and rewards (ie variable returns) an investor is unable to benefit from any power that it might have and therefore cannot control an investee.

BC35 In reaching its conclusions regarding control as the basis for consolidation, the Board also noted the following:

(a) One of the main objectives of the consolidation project is to develop a consistent basis for determining when an investor should consolidate an investee, irrespective of the nature of the investee. Some respondents to ED 10 suggested including a particular level of exposure to risks and rewards as a presumption of, or proxy for, control, in the context of investees that are not directed through voting or similar rights. The Board concluded that introducing such a presumption for a particular set of investees would contradict the objective of developing a single consistent basis for consolidation that applies to all investees.

(b) Having a different consolidation model for some investees necessitates defining precisely those investees to which that model applies. There have been difficulties, in practice, in identifying which investees are special purpose entities to which SIC-12 applied. A number of respondents to ED 10 noted that any attempt to split the continuum of investee types into distinct populations and to subject the different populations of entities to different consolidation models would lead to divergence in practice for investees that are not clearly in the specified population sets. For that reason, the Board decided not to carry forward the distinction proposed in ED 10 between different types of investees when assessing control (see paragraphs BC71–BC75).

(c) Including exposure to risks and rewards as a presumption of, or proxy for, control in particular situations puts more pressure on the measurement of that exposure. The Board was particularly concerned that the need to measure risks and rewards might result in the adoption of a consolidation model based on quantitative criteria (for example, a model focused on the majority of risks and rewards). Any quantitative analysis of risks and rewards would inevitably be complex and, as a consequence, difficult to understand, apply and audit. The Board noted that, depending on the specific facts and circumstances, a quantitative model might identify a controlling party that is different from the party that a qualitative analysis of the power over, and returns from, an investee would identify as the controlling party. The Board's analysis is consistent with concerns raised by the FASB's constituents on the quantitative consolidation model in Interpretation 46 (Revised) *Consolidation of Variable Interest Entities*. The FASB has since issued Statement of Financial Accounting Standard No. 167 *Amendments to FIN 46 (Revised)* to amend Interpretation 46 to require a qualitative analysis focusing on the power over and returns from an investee to determine control.*

(d) The Board believes that having a control model that applies to all investees is likely to reduce the opportunities for achieving a particular accounting outcome that is inconsistent with the economics of an investor's relationship with an investee—ie it will reduce structuring opportunities.

BC36 The Board does not regard control and risks and rewards as competing models. The exposure to risks and rewards, or variable returns as it is expressed in IFRS 10, is an essential element of control. In the great majority of cases the approaches would lead to the same accounting conclusions. However, a control-based model forces an investor to consider all its rights in relation to the investee rather than relying on arbitrary bright lines that are associated with risks and rewards approaches, such as paragraph 10(c) and (d) of SIC-12, which referred to control if the investor has rights to obtain the majority of the benefits of the investee or if the investor retains the majority of the risks related to the investee. The Board believes that an investor will, generally, want to control an investee when it has significant economic exposure. This should reduce the likelihood of structuring simply to achieve a particular accounting outcome.

Reputational risk

BC37 During the financial crisis, some financial institutions provided funding or other support to securitisation or investment vehicles because they established or promoted those vehicles. Rather than allowing them to fail and facing a loss of reputation, the financial institutions stepped in, and in some cases took control of the vehicles. ED 10 did not make any explicit reference to reputational risk in relation to control because the Board decided that having reputational risk in isolation is not an appropriate basis for consolidation. The term 'reputational risk' relates to the risk that failure of an investee would damage an investee's reputation and, therefore, that of an investor or sponsor, compelling the investor or sponsor to provide support to an investee in order to protect its reputation, even though the investor or sponsor has no legal or contractual requirement to do so.

* SFAS 167 was subsequently nullified by Accounting Standards Update No. 2009-17. The requirements of SFAS 167 have been included in Accounting Standards Update No. 2009-17.

BC38 Respondents to ED 10 agreed with the Board, almost unanimously, that reputational risk is not an appropriate basis for consolidation. Some, however, were of the view that reputational risk is part of an investor's exposure to risks and rewards and should be considered when determining control of an investee.

BC39 The Board believes that reputational risk is part of an investor's exposure to risks and rewards, albeit a risk that arises from non-contractual sources. For that reason, the Board concluded that when assessing control, reputational risk is a factor to consider along with other facts and circumstances. It is not an indicator of power in its own right, but may increase an investor's incentive to secure rights that give the investor power over an investee.

Definition of control

BC40 IFRS 10 states that an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the current ability to affect those returns through its power over the investee.

BC41 The definition of control includes three elements, namely an investor's:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) ability to use its power over the investee to affect the amount of the investor's returns.

Power

BC42 ED 10 proposed that in order to control an investee, an investor must have the power to direct the activities of that investee. IAS 27 defines control as the power to govern the financial and operating policies of an entity. The Board decided to change the definition of control because even though power is often obtained by governing the strategic operating and financing policies of an investee, that is only one of the ways in which power to direct the activities of an investee can be achieved. An investor can have the power to direct the activities of an investee through decision-making rights that relate to particular activities of an investee. Indeed, referring to the power to govern the financial and operating policies of an investee would not necessarily apply to investees that are not directed through voting or similar rights.

BC43 Respondents to ED 10 did not object to changing the definition of control to power to direct the activities of an investee. Many were confused, however, about what the Board meant by 'power to direct' and which 'activities' the Board had in mind. They asked for a clear articulation of the principle behind the term 'power to direct'. They also expressed the view that power should relate to significant activities of an investee, and not those activities that have little effect on the investee's returns.

BC44 ED 10 described various characteristics of power—power need not be absolute; power need not have been exercised; power precludes others from controlling an investee. ED 10 also implied that power could arise from rights that appeared to be exercisable only at some point in the future when particular circumstances arise or events happen. Respondents to ED 10 were confused about whether power referred to the legal or contractual power to direct, or to the ability to direct, which does not necessarily require the investor to have the legal or contractual right to direct the activities. Some respondents to ED 10 also commented that the statement that power precludes others from controlling an investee was confusing because it implied that an investor with less than a majority of the voting rights in an investee could never have power.

BC45 In response to the comments from respondents, the Board considered whether power should refer to having the *legal* or *contractual right* to direct the activities, or the *ability* to direct the activities.

BC46 According to a legal or contractual right approach, some would suggest that an investor has power only when it has an unassailable legal or contractual right to direct. This means having the right to make decisions about the activities of an investee that could potentially be contrary to the wishes of others in every possible scenario, within the boundaries of protective rights. Therefore, for example, an investor with less than half the voting rights of an investee could not have power unless it had additional legal or contractual rights (see paragraph BC101). Also, potential voting rights would not affect the assessment of control until exercised or converted because in and of themselves they do not give the holder the contractual right to direct. A consistent application of this view to 'kick-out' (removal) or similar rights would suggest that a decision maker could never have power when such rights are held by others because those rights could be exercised to remove the decision maker.

BC47 Supporters of the legal or contractual right approach point out that this approach requires less judgement than other approaches and, accordingly, is likely to result in more consistent application of the control definition. They are also concerned that other approaches might result in an investor frequently changing its assessment of control because of changes in circumstances. These changes could be outside the control of the investor (for example, changes in the shareholdings of others or market changes that affect the terms and conditions of potential voting rights).

BC48 The Board acknowledged that defining power as the legal or contractual right to direct the activities of an investee would require less judgement than some other approaches. Nonetheless, the Board rejected that approach because it would create opportunities for an investor to ignore those circumstances in which the Board believes that an investor controls an investee without having the unassailable legal or contractual right to direct the activities of the investee.

BC49 In addition, the Board concluded that preparers and others should be able to apply the judgement required by an 'ability' approach, as long as the principles underlying that approach were articulated clearly and the IFRS included application guidance, illustrating how control should be assessed.

BC50 Consequently, the Board concluded that power should refer to having the *current ability* to direct the activities of an investee. The Board observed that the current ability to direct the activities of an investee would, in all cases, arise from rights (such as voting rights, potential voting rights, rights within other arrangements, or a combination of these).

BC51 In addition, an investor would have the current ability to direct the relevant activities if that investor were able to make decisions at the time that those decisions need to be taken.

BC52 The Board also noted that an investor can have the current ability to direct the activities of an investee even if it does not actively direct the activities of the investee. Conversely, an investor is not assumed to have the current ability to direct simply because it is actively directing the activities of an investee. For example, an investor that holds a 70 per cent voting interest in an investee (when no other relevant factors are present) has the current ability to direct the activities of the investee even if it has not exercised its right to vote. Even if the remaining 30 per cent of voting rights were held by a single party actively exercising its voting rights, that minority shareholder would not have power.

BC53 The Board also noted that having the current ability to direct the activities of an investee is not limited to being able to act today. There may be steps to be taken in order to act—for example, an investor may need to initiate a meeting before it can exercise its voting or other rights that give it power. However, such a delay would not prevent the investor from having power, assuming that there are no other barriers that would prevent the investor from exercising its rights when it chooses to do so.

BC54 In addition, the Board observed that for some investees, particularly those with most of their operating and financing decisions predetermined, decisions that significantly affect the returns of the investee are not made continuously. Such decisions may be made only if particular events occur or circumstances arise. For such investees, having the ability to make those decisions if and when they arise is a source of a current ability to direct the relevant activities.

BC55 When discussing the principles underlying power, the Board rejected the assertion that an 'ability' approach could result in an investee moving *frequently* in and out of consolidation because of changes that are outside the control of the investor (see paragraph BC47). Changes as to which party controls an investee could occur according to any control model, including a 'contractual rights' model, when relevant facts and circumstances change. For a discussion of concerns in respect to changes in market conditions and the assessment of potential voting rights see paragraphs BC124 and BC152.

Relevant activities

BC56 ED 10 did not propose explicit guidance explaining the activities of an investee to which the definition of control referred. In response to comments received from respondents, the Board decided to clarify that in order to control an investee an investor must have the current ability to direct the activities of the investee that *significantly affect the investee's returns* (ie the relevant activities).

BC57 The comments on ED 10 suggested that such a clarification would be particularly helpful when assessing control of investees that are not directed through voting or similar rights and for which there may be multiple parties with decision-making rights over different activities.

BC58 If an investor controls such an investee, its power should relate to the activities of the investee that significantly affect the investee's returns, rather than administrative activities that have little or no effect on the investee's returns. For an investee that is not directed through voting or similar rights it can be difficult to determine which investor, if any, meets the power element of the control definition. There is also a risk that, without adding the modifier 'significant', an investor with very little ability to affect the returns could be considered to have power over that investee (for example, if the investor has the ability to direct the most significant of a number of insignificant activities that have little effect on the investee's returns).

BC59 Although the guidance included in IFRS 10 in this respect would be particularly helpful in the context of investees that are not directed through voting or similar rights, the Board concluded that the amended wording would work well for all investees. For an investee that is directed through voting or similar rights, it is generally the case that a range of operating and financing activities are those that significantly affect the investee's returns—for example, selling goods or services, purchasing inventory, making capital expenditures or obtaining finance. In that case, an investor that is able to determine the strategic operating and financing policies of the investee would usually have power.

Returns

BC60 The definition of control in IFRS 10 uses the concept of returns in two ways.

BC61 In order to have power over an investee an investor must have the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns. The link to returns was included in the first element of control in order to clarify that having the current ability to direct inconsequential activities is not relevant to the assessment of power and control (see paragraph BC58).

BC62 The second element of control requires the investor's involvement with the investee to provide the investor with rights, or exposure, to variable returns. This retains the concept that control conveys the rights to returns from an investee. To have control an investor must have power over the investee, exposure or rights to returns from its involvement with the investee and the ability to use its power to affect its own returns. Control is not a synonym of power, because equating power and control would result in incorrect conclusions in situations when an agent acts on behalf of others. ED 10 used the term 'returns' rather than 'benefits' because 'benefits' are often interpreted as implying only positive returns.

BC63 The Board confirmed its intention to have a broad definition of 'returns' that would include synergistic returns as well as more direct returns, for example, dividends or changes in the value of an investment. In practice, an investor can benefit from controlling an investee in a variety of ways. The Board concluded that to narrow the definition of returns would artificially restrict those ways of benefiting.

BC64 Although some respondents to ED 10 commented that 'returns' could be interpreted narrowly to refer only to financial returns such as dividends, the Board believed that the broad description of returns included in the IFRS should ensure that the Board's intention to have a broad definition is clear. The Board also confirmed that an investor's returns could have the potential to be wholly positive, wholly negative or both positive and negative.

BC65 When assessing control of an investee, an investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee. The Board considered whether this criterion should refer to involvement through instruments that must absorb variability, in the sense that those instruments reduce the exposure of the investee to risks that cause variability.

BC66 Some instruments are designed to transfer risk from a reporting entity to another entity. During its deliberations, the Board concluded that such instruments create variability of returns for the other entity but do not typically expose the reporting entity to variability of returns from the performance of the other entity. For example, assume an entity (entity A) is established to provide investment opportunities for investors who wish to have exposure to entity Z's credit risk (entity Z is unrelated to any other party involved in the arrangement). Entity A obtains funding by issuing to those investors notes that are linked to entity Z's credit risk (credit-linked notes) and uses the proceeds to invest in a portfolio of risk-free financial assets. Entity A obtains exposure to entity Z's credit risk by entering into a credit default swap (CDS) with a swap counterparty. The CDS passes entity Z's credit risk to entity A, in return for a fee paid by the swap counterparty. The investors in entity A receive a higher return that reflects both entity A's return from its asset portfolio and the CDS fee. The swap counterparty does not have involvement with entity A that exposes it to variability of returns from the performance of entity A because the CDS transfers variability to entity A, rather than absorbing variability of returns of entity A.

BC67 Consequently, the Board decided that it was not necessary to refer specifically to instruments that absorb variability, although it expects that an investor will typically have rights, or be exposed, to variability of returns through such instruments.

Link between power and returns

BC68 To have control, an investor must have power and exposure or rights to variable returns and be able to use that power to affect its own returns from its involvement with the investee. Thus, power and the returns to which an investor is exposed, or has rights to, must be linked. The link between power and returns does not mean that the proportion of returns accruing to an investor needs to be perfectly correlated with the amount of power that the investor has. The Board noted that many parties can have the right to receive variable returns from an investee (eg shareholders, debt providers and agents), but only one party can control an investee.

Control is not shared

BC69 ED 10 proposed that only one party, if any, can control an investee. The Board confirmed this in deliberating IFRS 10. (See further comments regarding joint arrangements in paragraph BC83.)

BC70 ED 10 proposed that an investor need not have absolute power to control an investee. Other parties can have protective rights relating to the activities of an investee. For example, limits on power are often imposed by law or regulations. Similarly, other parties—such as non-controlling interests—may hold protective rights that limit the power of the investor. During its redeliberations the Board confirmed that an investor can control an investee even if other entities have protective rights relating to the activities of the investee. Paragraphs BC93–BC124 discuss rights that give an investor power over an investee.

Assessing control

BC71 In developing IFRS 10 the Board, while acknowledging that the factors to be considered in assessing control will vary, had the objective of developing a control model that applies the same concept of control as the basis for consolidation to all investees, irrespective of their nature.

BC72 In ED 10, the Board set out specific factors to consider when assessing control of a structured entity. ED 10 defined a structured entity as an entity whose activities are restricted to the extent that those activities are, in essence, not directed by voting or similar rights.

BC73 The Board's intention when including the subsection specifically for structured entities was as a convenience for those assessing control of traditional operating entities that are typically controlled through voting rights—the Board did not want to force those assessing control of traditional operating entities to read, and assess whether to apply, all the guidance relating to structured entities if that guidance was not relevant.

BC74 However, the vast majority of respondents to ED 10 were opposed to creating a subset of investees for which different guidance would apply when assessing control. In their view, such an approach would perpetuate problems faced in applying the guidance in IAS 27 and SIC-12—two control models leading to inconsistent application and, therefore, potential arbitrage by varying investee-specific characteristics. Respondents also noted that the guidance provided for structured entities should apply generally to all investees. Therefore, they suggested that there should be a single section that combines guidance on assessing control of all investees.

BC75 The Board was persuaded by this reasoning and decided to combine the guidance for assessing control of an investee within a single section, noting that its intention is to have a single basis for consolidation that could be applied to all investees and that that basis is control. However, the Board acknowledged that the way in which control would need to be assessed would vary depending on the nature of investees.

Understanding the purpose and design of an investee

BC76 Some respondents to ED 10 expressed the view that involvement in the design of an investee (with restricted activities) is a strong indicator of control and, indeed, in some situations, they would conclude that involvement in the design alone is sufficient to meet the power element of the control definition. SIC-12 included this notion as one of its indicators of control and the accompanying Basis for Conclusions explained that:

> SPEs [special purpose entities] frequently operate in a predetermined way so that no entity has explicit decision-making authority over the SPE's ongoing activities after its formation (ie they operate on 'autopilot'). Virtually all rights, obligations, and aspects of activities that could be controlled are predefined and limited by contractual provisions specified or scheduled at inception. In these circumstances, control may exist for the sponsoring party or others with a beneficial interest, even though it may be particularly difficult to assess, because virtually all activities are predetermined. However, the predetermination of the activities of the SPE through an 'autopilot' mechanism often provides evidence that the ability to control has been exercised by the party making the predetermination for its own benefit at the formation of the SPE and is being perpetuated.

BC77 When developing IFRS 10 the Board confirmed the position in ED 10 that being involved in setting up an investee was not, in and of itself, sufficient to conclude that an investor has control. Being involved in the design does not necessarily mean that an investor has decision-making rights to direct the relevant activities. Often several parties are involved in the design of an investee and the final structure of the investee includes whatever is agreed to by all those parties (including investors, the sponsor of the investee, the transferor(s) of the assets held by the investee and other parties involved in the transaction).

BC78 Although the success of, for example, a securitisation will depend on the assets that are transferred to the securitisation vehicle, the transferor might not have any further involvement with the vehicle and thereby may not have any decision-making rights to direct the relevant activities. The benefits from being involved in setting up a vehicle could cease as soon as the vehicle is established. The Board concluded that, in isolation, being involved in setting up an investee would not be an appropriate basis for consolidation.

BC79 The Board confirmed, however, that considering the purpose and design of an investee is important when assessing control. Understanding the purpose and design of an investee is the means by which an investor identifies the relevant activities, the rights from which power arises and who holds those rights. It can also assist in identifying investors that may have sought to secure control and whose position should be understood and analysed when assessing control.

BC80 The Board noted that understanding the purpose and design of an investee also involves consideration of all activities and returns that are closely related to the investee, even though they might occur outside the legal boundaries of the investee. For example, assume that the purpose of a securitisation vehicle is to allocate risks (mainly credit risk) and benefits (cash flows received) of a portfolio of receivables to the parties involved with the vehicle. The vehicle is designed in such a way that the only activity that can be directed, and can significantly affect the returns from the transaction, is managing those receivables when they default. An investor might have the current ability to direct those activities that significantly affect the returns of the transaction by, for example, writing a put option on the receivables that is triggered when the receivables default. The design of the vehicle ensures that the investor has decision-making authority over the relevant activities at the only time that such decision-making authority is required. In this situation, the terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement would be considered together with the founding documents of the investee to conclude whether the investor has the current ability to direct the activities of the securitisation vehicle that significantly affect the returns of the transaction (even before the default of the receivables).

Different activities significantly affect the returns

BC81 IAS 27, SIC-12 and ED 10 did not specifically address situations in which multiple parties have decision-making authority over the activities of an investee. Some respondents to ED 10 questioned how the control model would be applied in such situations. Respondents were concerned that the absence of specific guidance would create structuring opportunities to avoid the consolidation of structured entities—they asserted that, without any guidance, power could easily be disguised and divided among different parties so that it could be argued that no one would have power over the investee.

BC82 The Board identified the following situations in which multiple parties may have decision-making authority over the activities of an investee:

(a) joint control

(b) shared decision-making that is not joint control

(c) multiple parties that each have unilateral decision-making rights to direct different activities of an investee that significantly affect the investee's returns.

Joint control

BC83 IFRS 11 *Joint Arrangements* defines joint control as the contractually agreed sharing of control of an arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. When two or more parties have joint control of an investee, no single party controls that investee and, accordingly, the investee is not consolidated. IFRS 11 is applicable to all investees for which two or more parties have joint control. The Board confirmed that IFRS 10 does not change or amend the arrangements that are now within the scope of IFRS 11.

Shared decision-making that is not joint control

BC84 The power to direct the relevant activities can be shared by multiple parties but those rights may not meet the definition of joint control. For example, five parties each own 20 per cent of entity Z, and each has one seat on entity Z's board of directors. All strategic operating and financing decisions (ie decisions in respect of the activities that significantly affect the returns of entity Z) require the consent of any four of the five directors. The five parties do not jointly control entity Z because unanimous consent is not required for decisions relating to the activities of entity Z that significantly affect its returns. Nevertheless, it is clear that the power to direct the activities of entity Z is shared and no single party controls entity Z. Again, the Board confirmed that the requirements of IFRS 10 do not change or amend the application of IFRSs to such situations.

Multiple parties with decision-making rights

BC85 When discussing the sharing of power, the Board noted that for most investees it will be clear that one party or body has decision-making authority to direct the activities of an investee that significantly affect the investee's returns. For example, for an investee that is directed by voting or similar rights, the governing body or board of directors would typically be responsible for strategic decision-making. Thus, the current ability to direct that body would be the basis for power.

BC86 Nonetheless, it is possible that more than one party has decision-making authority over different activities of an investee and that each such activity may significantly affect the investee's returns—respondents to ED 10 noted the following as examples: multi-seller conduits, multi-seller securitisations, and investees for which the assets are managed by one party and the funding is managed by another. The Board was persuaded by the comments from respondents that IFRS 10 should specifically address situations for which multiple parties each have unilateral decision-making rights to direct different activities of the investee.

BC87 The Board considered whether, for such investees, none of the parties controls the investee because the ability to direct the activities is shared. If those different activities, in fact, significantly affect the returns of the investee, some would reason that it would be artificial to force the parties involved to conclude that one activity is more important than the others. An investor might be required to consolidate an investee when the investor would not have the power to direct *all* the activities of the investee that significantly affect the investee's returns.

BC88 Nonetheless, the Board decided that when two or more unrelated investors each have unilateral decision-making rights over different activities of an investee that significantly affect the investee's returns, the investor that has the current ability to direct the activities of the investee that *most* significantly affect the investee's returns meets the power element of the control definition. The expectation is that one investor will have that ability to direct the activities that *most* significantly affect the investee's returns and consequently would be deemed to have power. In effect, power is attributed to the party that looks most like the party that controls the investee. However, the Board decided not to prescribe a specific mechanism for assessing which activities of an investee *most* significantly affect the investee's returns.

BC89 The Board was concerned about creating the potential to avoid consolidation if an investor were to conclude that it has power only when it has the current ability to direct *all* the relevant activities. Such a requirement would be open to abuse because an investor could avoid consolidation by involving other parties in an investee's decision-making.

BC90 The Board's conclusions result in greater potential for an investee to be consolidated because one party would be deemed to have power when multiple parties have unilateral decision-making authority over different activities of an investee.

BC91 In reaching its conclusions, the Board noted that the situation in which two or more investors (individually or as a group) have decision-making rights over different activities of an investee that significantly affect the investee's returns is not expected to arise frequently. This is because one party or body usually has overall decision-making responsibility for an investee (see paragraph BC85). The Board believes that its conclusions in this respect will ensure that it does not create an incentive to structure investees to achieve an accounting outcome by involving multiple parties in decision-making when there is no business rationale to do so.

BC92 The Board noted that in situations where two or more parties have the current ability to direct the activities that most significantly affect the investee's returns and if unanimous consent is required for those decisions IFRS 11 applies.

Rights that give an investor power

BC93 IAS 27 and SIC-12 do not include guidance on rights that give an investor power, other than voting rights and potential voting rights. In addition, neither discusses the effect that such rights held by other parties have on the rights of an investor.

BC94 The Board addressed this issue to some extent in ED 10 by including guidance on protective rights. However, comments from respondents to ED 10 suggested that the guidance was not sufficient.

BC95 The Board decided to address the insufficiency by providing additional guidance about the activities that an investor must be able to direct in order to have power (ie those activities that significantly affect the investee's returns) and by providing guidance on when those rights are substantive. The Board believes that including such guidance should help an investor to determine whether it controls an investee, or whether the rights held by other parties are sufficient to prevent an investor from controlling an investee.

Voting rights

BC96 As with IAS 27 and ED 10, the Board decided to include guidance in IFRS 10 that addresses the assessment of control of investees that are controlled by voting rights.

Majority of voting rights

BC97 The Board carried forward the concept from IAS 27, with a modification to the words, that an investor that holds more than half the voting rights of an investee has power over the investee when those voting rights give the investor the current ability to direct the relevant activities (either directly or by appointing the members of the governing body). The Board concluded that such an investor's voting rights are sufficient to give it power over the investee regardless of whether it has exercised its voting power, unless those rights are not substantive or there are separate arrangements providing another entity with power over the investee (such as through a contractual arrangement over decision-making or substantive potential voting rights).

Less than a majority of voting rights

BC98 In October 2005* the Board stated that IAS 27 contemplates that there are circumstances in which an investor can control an investee without owning more than half the voting rights of that investee. The Board accepted that at that time IAS 27 did not provide clear guidance about the particular circumstances in which this will occur and that, as a consequence, there was likely to be diversity in practice.

BC99 The Board decided that in ED 10 it would explain clearly that an investor can control an investee even if the investor does not have more than half the voting rights, as long as the investor's voting rights are sufficient to give the investor the current ability to direct the relevant activities. ED 10 included an example of when a dominant shareholder holds voting rights and all other shareholdings are widely dispersed, and those other shareholders do not actively co-operate when they exercise their votes, so as to have more voting power than the dominant shareholder.

BC100 Respondents to ED 10 expressed mixed views about whether an investor could ever control an investee with less than half the voting rights and without other contractual rights relating to the activities of the investee.

BC101 Some who supported a 'contractual rights' control model believe that an investor with less than half the voting rights of an investee (and without other contractual rights) cannot control that investee. They reasoned that this is because the investor contractually does not have the unassailable right to direct the activities of the other investee in every possible scenario and cannot necessarily block the actions of others.

* The October 2005 edition of *IASB Update* included a statement from the Board outlining its views on control with less than a majority of voting rights.

BC102 Supporters of the ‘contractual rights’ model believe that power should not be defined in a way that relies on the inactivity of other shareholders, as would be the case in an ‘ability’ model. In addition, they believe that if an investor wishes to control an investee, that investor would need to have a majority of the voting rights, or further contractual rights (in addition to its voting rights if necessary) that guarantee its power over the investee.

BC103 Other respondents supported the ‘ability’ model proposed in ED 10. They agreed with the Board that there are situations in which an investor with less than half the voting rights of an investee can control that investee, even when the investor does not have other contractual rights relating to the activities of the investee. However, they asked the Board to clarify when that would be the case. In particular, they questioned the following:

(a) The proposals in the exposure draft implied that an investor might have to consolidate an investee simply because the remaining shareholdings are widely dispersed or attendance at shareholder meetings is low, even though the investor might hold only a low percentage of voting rights in that investee (eg 10 per cent or 15 per cent).

(b) The proposals implied that an investor might be forced to obtain information about the shareholder structure, the degree of organisation and the other shareholders’ future intentions. This would be particularly difficult to obtain if the investor owned a low percentage of the voting rights of an investee.

BC104 The Board noted the concerns raised by respondents but concluded that it would be inappropriate to limit power to situations in which an investor would have the contractual right to direct the activities of an investee, for the reasons noted in paragraphs BC45–BC50. Specifically in the context of voting rights, the Board believes that there are situations in which an investor can control an investee even though it does not own more than half the voting rights of an investee and does not have other contractual rights relating to the activities of the investee.

BC105 In reaching that conclusion, the Board noted that jurisdictions have differing legal and regulatory requirements relating to the protection of shareholders and investors. Those requirements often determine or influence the rights held by shareholders and consequently have an influence on the ability of an investor to have power over an investee with less than half the voting rights. For that reason, the Board concluded that drawing a line at 50 per cent in terms of voting power could lead to inappropriate consolidation conclusions in some jurisdictions.

BC106 The Board also concluded that an ‘ability’ model would result in more appropriate consolidation conclusions not only when applied in different jurisdictions, but also when applied to all investees. This is because the ‘ability’ model would be applied consistently to all investees by considering the rights held by the investor, as well as the rights held by other parties, when assessing control. For example, in the context of voting rights, an investor would assess whether its voting and any other contractual rights would be sufficient to give it the current ability to direct the relevant activities, or whether the voting and other rights held by other shareholders could prevent it from directing the relevant activities if those shareholders chose to act. The model would be applied in a similar way when other parties hold potential voting rights, kick-out rights or similar rights.

BC107 In response to the concerns raised by respondents to ED 10, the Board clarified that its intentions were neither to require the consolidation of all investees, nor to require an investor that owns a low percentage of voting rights of an investee (such as 10 per cent or 15 per cent) to consolidate that investee. An investor should always assess whether its rights, including any voting rights that it owns, are sufficient to give it the current ability to direct the relevant activities. That assessment requires judgement, considering all available evidence.

BC108 The Board decided to add application requirements setting out some of the factors to consider when applying that judgement to situations in which no single party holds more than half the voting rights of an investee. In particular, the Board decided to clarify that it expects that:

(a) the more voting rights an investor holds (ie the larger its absolute holding), the more likely it will have power over an investee;

(b) the more voting rights an investor holds relative to other vote holders (ie the larger its relative holding), the more likely the investor will have power over an investee; and

(c) the more parties that would need to act together to outvote the investor, the more likely the investor will have power over an investee.

BC109 The Board also noted that, in some cases, considering the voting rights and potential voting rights that an investor and others hold, together with contractual rights, will be sufficient to determine whether the investor has power. However, in other cases these factors may not be sufficient to enable a determination to be made and additional evidence would need to be considered for an investor to determine whether it has power. IFRS 10 sets out additional factors to be considered in these circumstances. In particular, the Board noted that the fewer voting rights an investor holds and the fewer parties that would need to act together to outvote the investor, the more reliance would need to be placed on additional evidence to determine whether the investor has power.

BC110 The Board also decided to clarify that if, after all available evidence has been considered, the evidence is not sufficient to conclude that the investor has power, the investor should not consolidate the investee. If an investor controls an investee, that conclusion is reached on the basis of evidence that is sufficient to conclude that the investor's rights give it the current ability to direct the relevant activities. The Board's intention was not to create a presumption that in the absence of evidence to the contrary the shareholder with the largest proportion of voting rights controls an investee.

BC111 It might be the case that when an investor initially acquires voting rights in an investee and assesses control solely by considering the size of that holding and the voting rights held by others, sufficient evidence is not available to conclude that the investor has power. If that is the case, the investor would not consolidate the investee. However, the assessment should be reconsidered as additional evidence becomes available. For example, the voting rights held by an investor and others may be unchanged but over time the investor may have been able to appoint a majority of the investee's board of directors and may have entered into significant transactions with the investee, thereby enabling the overall assessment to be made that the investor now has control and should consolidate the investee.

Potential voting rights

BC112 An investor might own options, convertible instruments or other instruments that, if exercised, would give the investor voting rights.

BC113 IAS 27 referred to those instruments as potential voting rights. According to that standard, the existence and effect of potential voting rights that are currently exercisable or convertible were considered when assessing control. If the options or convertible instruments that give an investor potential voting rights are currently exercisable, IAS 27 required the investor to treat those potential voting rights as if they were current voting rights. According to IAS 27, the investor had to consider all facts and circumstances except the intentions of management and the financial ability to exercise or convert such rights.

BC114 Because of the revised definition of control, the Board reconsidered potential voting rights in developing the guidance in IFRS 10.

BC115 The questions that the Board considered with respect to potential voting rights were:

(a) Can potential voting rights give the holder the current ability to direct the relevant activities of an investee to which those potential voting rights relate?

(b) If so, in what situations do potential voting rights give the holder the current ability to direct the relevant activities of that investee?

BC116 The Board proposed in ED 10 that an investor should assess whether its power from holding potential voting rights, considered together with other facts and circumstances, gives it power over the investee. Such an investor would have power if the governing body acts in accordance with the wishes of the investor, the counterparty to the instrument acts as an agent for the investor or the investor has particular contractual rights that give it power.

BC117 Most respondents to ED 10 agreed that unexercised potential voting rights, taken in conjunction with other facts and circumstances, could give an investor power. However, many were confused by the application guidance—how would one know whether the decisions of the governing body were in accordance with the wishes of the investor? The respondents suggested that the other situations described in the discussion of power through potential voting rights could lead to power for reasons other than the potential voting rights instrument.

BC118 The Board concluded that the guidance in IFRS 10 that addresses control should apply to potential voting rights, ie when assessing control, an investor should consider all rights that it and other parties hold, including potential voting rights, to determine whether its rights are sufficient to give it control.

BC119 The Board observed that concluding that such instruments always or never give the holder control would cause inappropriate consolidation decisions in some cases.

BC120 Accordingly, the Board concluded that potential voting rights can give the holder the current ability to direct the relevant activities. This will be the case if those rights are substantive and on exercise or conversion (when considered together with any other existing rights the holder has) they give the holder the current ability to direct the relevant activities. The holder of such potential voting rights has the contractual right to 'step in', obtain voting rights and subsequently exercise its voting power to direct the relevant activities—thus the holder has the current ability to direct the activities of an investee at the time that decisions need to be taken if those rights are substantive.

BC121 The Board noted that the holder of such potential voting rights is, in effect, in the same position as a passive majority shareholder or the holder of substantive kick-out rights. The control model would provide that, in the absence of other factors, a majority shareholder controls an investee even though it can take time for the shareholder to organise a meeting and exercise its voting rights. In a similar manner, it can take time for a principal to remove or 'kick out' an agent. The holder of potential voting rights must also take steps to obtain its voting rights. In each case, the question is whether those steps are so significant that they prevent the investor from having the current ability to direct the relevant activities of an investee.

BC122 The Board observed that if power was characterised as requiring either the contractual right to direct the activities or active direction of the activities, the holder of unexercised potential voting rights would never have power without other contractual rights. However, power is the *current ability* to direct the activities of an investee. As such, the Board concluded that there are situations in which substantive potential voting rights can give the holder power before exercise or conversion to obtain those rights.

BC123 In response to comments from respondents to add clarity about when the holder of potential voting rights has power and to ensure that the control model is applied consistently, the Board added guidance and application examples to help assess when potential voting rights are substantive. Although that assessment requires judgement, the Board believes that an investor should be able to apply the judgement required. This is because potential voting rights exist for a reason—the terms and conditions of the instruments reflect that reason. Therefore, an assessment of the terms and conditions of the instrument (ie the purpose and design of the instrument) should provide information about whether the instrument was designed to give the holder power before exercise or conversion.

BC124 Some constituents were concerned about whether the proposed model would lead to frequent changes in the control assessment solely because of changes in market conditions—would an investor consolidate and deconsolidate an investee if potential voting rights moved in and out of the money? In response to those comments, the Board noted that determining whether a potential voting right is substantive is not based solely on a comparison of the strike or conversion price of the instrument and the then current market price of its underlying share. Although the strike or conversion price is one factor to consider, determining whether potential voting rights are substantive requires a holistic approach, considering a variety of factors. This includes assessing the purpose and design of the instrument, considering whether the investor can benefit for other reasons such as by realising synergies between the investor and the investee, and determining whether there are any barriers (financial or otherwise) that would prevent the holder of potential voting rights from exercising or converting those rights. Accordingly, the Board believes that a change in market conditions (ie the market price of the underlying shares) alone would not typically result in a change in the consolidation conclusion.

Delegated power (agency relationships)

BC125 IAS 27 and SIC-12 did not contain requirements or guidance to assess whether a decision maker is an agent or principal. The absence of guidance has allowed divergence to develop in practice. The Board decided to introduce principles that address agency relationships to reduce this divergence.

BC126 ED 10 proposed criteria to identify an agency relationship on the basis of the following assumptions:

(a) Both the principal and the agent seek to maximise their own benefits. Therefore, the principal is likely to introduce additional measures that are intended to ensure that the agent does not act against the interest of the principal. For example, the principal may have rights to remove the agent with or without cause.

(b) A principal has no incentive to remunerate an agent more than what is commensurate with the services provided. Accordingly, remuneration that is not commensurate with the services provided is an indicator that a decision maker is not an agent.

BC127 ED 10 included guidance on dual roles and addressed situations in which an investor holds voting rights, both directly and on behalf of other parties as an agent. The exposure draft proposed that when assessing whether an investor acts as an agent or a principal, the investor would exclude the voting rights that it holds as an agent only if it could demonstrate that it is obliged to act in the best interests of other parties or has implemented policies and procedures that ensure the independence of the decision maker in its role as an agent from that as a holder of voting rights directly.

BC128 Most respondents to ED 10 agreed with the Board that the consolidation standard should provide application guidance to identify an agency relationship. However, some respondents believed that the exposure draft was not clear on whether the Board intended the proposed application guidance to be limited to legal or contractual agency relationships. Most respondents agreed that the form of remuneration can be an indicator of an agency relationship. However, many found the application guidance, in this respect, confusing. They did not agree with the dual role guidance that required an investor to assess in aggregate its rights as an agent and a principal. Nor did they believe that such an investor should automatically exclude its rights as an agent from the control assessment.

BC129 In response to those comments, the Board decided to base its principal/agent guidance on the thinking developed in agency theory. Jensen and Meckling (1976) define an agency relationship as 'a contractual relationship in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.'*

BC130 The Board clarified that, as defined, an agent is obliged to act in the best interests of the parties that delegated the power (ie the principal or principals) and not other parties by way of a wider fiduciary responsibility. The Board did not think it would be appropriate to conclude that every party that is obliged, by law or contract, to act in the best interests of other parties is an agent for the purposes of assessing control. This conclusion, in effect, assumes that a decision maker that is legally or contractually obliged to act in the best interests of other parties will always do so, even if that decision maker receives the vast majority of the returns that are influenced by its decision-making. Although this assumption might be appropriate for some decision makers, the Board observed that it would not be appropriate for all, in particular many investees that are not directed through voting or similar rights. Almost every investment or asset manager could contend that it is contractually obliged to act in the best interests of others. This conclusion could result in virtually

* M C Jensen and W H Meckling, Theory of the Firm: Managerial Behavior Agency Costs and Ownership Structure, Journal of Financial Economics 1976, pp. 305-360

every investee that is not directed through voting or similar rights being unconsolidated.

BC131 The Board observed that the difficulty in developing guidance that addresses agency relationships is that the link between power and returns is often missing. To have control, an investor must have power and be able to use that power for its own benefit.

BC132 If a decision maker receives a return that is relatively insignificant or varies insignificantly, most would be comfortable concluding that the decision maker uses any decision-making authority delegated to it to affect the returns received by others—this is because the decision maker would not have power for its own benefit. Similarly, if the decision maker held a substantial investment in the investee (say, a 95 per cent investment), most would conclude that the decision maker uses any decision-making authority delegated to it primarily to affect the returns it receives—the decision maker would have power for its own benefit. But at what point, between insignificant and very significant, does the decision maker change from using any decision-making authority primarily for others to using its authority primarily for itself?

BC133 The Board concluded that the guidance in IFRS 10 that addresses control should apply to agency relationships, ie when assessing control, a decision maker should consider whether it has the current ability to direct the relevant activities of an investee that it manages to affect the returns it receives, or whether it uses the decision-making authority delegated to it primarily for the benefit of other parties.

BC134 The Board observed that a decision maker always acts as an agent of another party when that other party holds a unilateral substantive right to remove the decision maker. Therefore, a substantive removal right that is held by a single party is a conclusive indicator of an agency relationship.

BC135 At the FASB's round-table meeting on consolidation in November 2010, participants asked whether a board of directors (or other governing body) can be evaluated as one party when considering whether a single party holds substantive removal rights. The IASB observed that the function of such governing bodies is to act as a fiduciary for the investors and therefore any rights given to an investee's board of directors (or other governing body) is a pass-through mechanism for the exercise of the investors' rights. Thus, the governing body itself cannot be considered to have or restrict decision-making authority over the investee. Rather it is the rights given to such a governing body by the investors and their effect on the decision-making authority that should be considered. Consequently, a governing body is not generally viewed as a single party.

BC136 In the absence of a substantive removal right that is held by a single party, judgement must be applied when assessing whether a decision maker acts as a principal or an agent. That assessment includes considering the overall relationship between the decision maker, the entity being managed and the other interest holders, taking into account all available evidence.

BC137 With the exception of substantive removal rights that are held by one party, no single factor would provide conclusive evidence of an agency relationship. The Board observed that, depending on the facts and circumstances, a particular factor may be a strong indicator of an agency relationship and would receive a greater weighting than other factors when assessing control. However, the weighting would depend on the relevant facts and circumstances in each case and it would be inappropriate to specify that any factor would always be more important than the others.

Scope of decision-making authority

BC138 One of the factors to consider when assessing whether a decision maker is an agent or principal is the scope of its decision-making authority. The Board considered whether a decision maker would always be considered an agent if the breadth of its decision-making authority were restricted by contractual arrangements. The Board rejected such a conclusion for two reasons. First, it noted that it is rare for a parent to have unrestricted power over a subsidiary because debt providers or non-controlling interests often have protective rights that restrict the decision-making powers of a parent to some extent. Consequently, it would be difficult to set a particular threshold of restriction on decision-making that would automatically lead to a conclusion that the decision maker is an agent. The second reason was that it would inappropriately lead to many investees, such as securitisation vehicles, not being classified as a controlled entity by a decision maker even though it might have significant economic interests in the investee as well as discretion in making decisions about the relevant activities of the investee. The Board observed that a decision maker can have power over an investee if it has discretion in directing the relevant activities, even if those activities are restricted when the investee is established.

Rights held by other parties

BC139 When considering rights held by other parties in the context of a principal/agent analysis, the Board noted that an entity would assess whether those rights are substantive in the same way as any other rights held by other parties, such as voting rights. An entity would assess whether those rights give their holders the practical ability to prevent the decision maker from directing the activities of the investee if the holders choose to exercise those rights.

BC140 Some constituents said that it would be beneficial to address liquidation rights held by other parties. The Board observed that removal rights are defined as 'rights to deprive the decision maker of its decision-making authority' and that some other rights (such as some liquidation rights) may have the same effect on the decision-making authority as removal rights. If those other rights meet the definition of removal rights, they should be treated as such regardless of their label. Therefore, the Board concluded that there was no need to add further guidance in this respect in the IFRS.

Exposure to variability of returns

BC141 The Board considered whether to specify that in the absence of other parties having substantive removal rights, a decision maker that receives a particular level of returns or exposure to variability of returns would be deemed to control an investee (for example, exposure to more than half of the variability of returns of an investee). However, the Board rejected developing a model that would specify a particular level of returns that would result in the determination of an agency relationship. Rather, the Board concluded that the more a decision maker is exposed to the variability of returns from its involvement with an investee, the more likely it is that the decision maker is a principal.

BC142 Although prescribing a quantitative approach for assessing returns, and specifying a particular level of returns, might lead to more consistent application of the requirements by removing some of the judgement required, the Board observed that such an approach was likely to lead to inappropriate consolidation conclusions in some situations. It would create a bright line that might encourage structuring to achieve a particular accounting outcome. The Board also noted that when assessing agency relationships, a decision maker's exposure to variability of returns is not necessarily correlated with the amount of power that it has, unlike the general assumption when investees are controlled by voting rights. Therefore, a decision maker does not necessarily have any more power over an investee when it is exposed, for example, to more than half of the variability of an investee's returns than when it is not.

Relationship with other parties

BC143 The Board decided that an investor should, when assessing control, consider the nature of its relationships with other parties. An investor may conclude that the nature of its relationship with other parties is such that those other parties are acting on the investor's behalf (they are 'de facto agents'). Such a relationship need not involve a contractual arrangement, thereby creating a non-contractual agency relationship. The Board concluded that a party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf.

BC144 ED 10 included a list of examples of parties that often act for the investor. The Board's intention was that an investor would look closely at its relationships with such parties and assess whether the party is acting on behalf of the investor.

BC145 Some respondents said that the list of examples of parties that often act on behalf of an investor was not helpful because they could think of circumstances in which it would be appropriate to regard each of the parties as agents of the investor and other circumstances when it would not. Respondents were unclear about the consequences of concluding that a party acts for an investor.

BC146 The Board clarified its intentions by stating that, when assessing control, an investor would consider its de facto agent's decision-making rights and exposure (or rights) to variable returns together with its own as if the rights were held by the investor directly. In reaching this decision, the Board noted that it would be inappropriate to assume that all other parties listed in paragraph B75 would *always* or *never* act for the investor. It acknowledged that the assessment of whether the nature of the relationship between the investor and the other party is such that the other party is a de facto agent requires judgement, including consideration of the nature of the relationship and the way that the parties interact with each other.

Control of specified assets

BC147 ED 10 introduced the term 'silo'—an investee within a legal structure—without defining it, noting that an investee can comprise more than one entity. This would be the case when the legal and contractual arrangements relating to an investee give one party control of a particular set of assets and liabilities, whereas another party might have control over another set of assets and liabilities within the investee. Respondents to ED 10 requested more guidance in order to apply the concept in practice.

BC148 In response to those requests, IFRS 10 includes application requirements regarding interests in specified assets. This guidance is consistent with the current guidance in US GAAP in that it sets out when a portion of an investee is treated as a separate entity for the purposes of consolidation. The Board noted that this situation arises most often in the context of investees that are not directed through voting or similar rights. However, the Board decided that to restrict the application requirements to investees that are not directed through voting or similar rights would be contrary to the objective of developing a control model that is applied consistently to all investees. In addition, the Board was not aware of any reason for such a restriction. Therefore, the guidance regarding interests in specified assets is applicable to all investees. This is in contrast with US GAAP, which applies this guidance only to portions of variable interest entities.

Continuous assessment

BC149 ED 10 proposed that an investor should assess control continuously. This is because the Board believes that the assessment of control requires consideration of all facts and circumstances and it would be impossible to develop reconsideration criteria that would apply to every situation in which an investor obtains or loses control of an investee. Therefore, the reassessment of control only when particular reconsideration criteria are met would lead to inappropriate consolidation decisions in some cases.

BC150 Most respondents to ED 10 did not comment on the requirement to assess control continuously. Some questioned whether the continuous assessment of control could be interpreted as requiring preparers to reassess control at the end of each reporting period.

BC151 The Board confirmed the proposal in ED 10 to require an investor to assess control continuously, and clarified that this would mean reassessing control when there is a change in relevant facts and circumstances that suggest that there is a change to one or more of the three elements of control. Such reassessment would not be restricted to each reporting date, nor would the requirement necessarily demand the reassessment of all control or potential control relationships at each reporting date.

BC152 Participants in the FASB's round-table meeting on consolidation held in November 2010 expressed concern about the reassessment of control (including a decision maker's status as principal or agent) when there are changes in market conditions, in particular the reassessment of control in the context of potential voting rights. In response to those concerns, the IASB decided to add guidance to address the reassessment of control (including a decision maker's status as principal or agent) when there are changes in market conditions (for the reassessment of control in the context of potential voting rights see paragraph BC124). The Board observed that a change in market conditions alone would not generally affect the consolidation conclusion, or the status as a principal or an agent, for two reasons. The first is that power arises from substantive rights, and assessing whether those rights are substantive includes the consideration of many factors, not only those that are affected by a change in market conditions. The second is that an investor is not required to have a particular specified level of exposure to variable returns in order to control an investee. If that were the case, fluctuations in an investor's expected returns might result in changes in the consolidation conclusion.

BC153 Nonetheless, the Board confirmed that control should be reassessed when relevant facts and circumstances change to such an extent that there is a change in one or more of the three elements of control or in the overall relationship between a principal and an agent.

Accounting requirements

Consolidation procedures

BC154 The application requirements in IFRS 10 explain how potential voting rights should be accounted for in the consolidated financial statements. Paragraphs B89–B91 replace the guidance previously included in the implementation guidance accompanying IAS 27, but are not intended to change consolidation procedures.

Non-controlling interests (2003 revision and 2008 amendments)

BCZ155 The 2008 amendments to IAS 27 changed the term 'minority interest' to 'non-minority interest'. The change in terminology reflects the fact that the owner of a minority interest in an entity might control that entity and, conversely, that the owners of a majority interest in an entity might not control the entity. 'Non-controlling interest' is a more accurate description than 'minority interest' of the interest of those owners who do not have a controlling interest in an entity.

BCZ156 Non-controlling interest was defined in IAS 27 as the equity in a subsidiary not attributable, directly or indirectly, to a parent (this definition is now in IFRS 10). Paragraph 26 of IAS 27 (as revised in 2000) required minority (non-controlling) interests to be presented in the consolidated balance sheet (statement of financial position) separately from liabilities and the equity of the shareholders of the parent.

BCZ157 As part of its revision of IAS 27 in 2003, the Board amended this requirement to require minority (non-controlling) interests to be presented in the consolidated statement of financial position within equity, separately from the equity of the shareholders of the parent. The Board concluded that a minority (non-controlling) interest is not a liability because it did not meet the definition of a liability in the *Framework for the Preparation and Presentation of Financial Statements* (replaced in 2010 by the *Conceptual Framework for Financial Reporting*).

BCZ158 Paragraph 49(b) of the *Framework* (now paragraph 4.4(b) of the *Conceptual Framework*) stated that a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Paragraph 60 of the *Framework* (now paragraph 4.15 of the *Conceptual Framework*) explained that an essential characteristic of a liability is that the entity has a present obligation and that an obligation is a duty or responsibility to act or perform in a particular way. The Board noted that the existence of a minority (non-controlling) interest in the net assets of a subsidiary does not give rise to a present obligation, the settlement of which is expected to result in an outflow of economic benefits from the group.

BCZ159 Instead, the Board noted that minority (non-controlling) interests represent the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore met the *Framework*'s definition of equity. Paragraph 49(c) of the *Framework* (now paragraph 4.4(c) of the *Conceptual Framework*) stated that equity is the residual interest in the assets of the entity after deducting all its liabilities.

Attribution of losses (2008 amendments)

BCZ160 IAS 27 (as revised in 2003) stated that when losses attributed to the minority (non-controlling) interests exceed the minority's interests in the subsidiary's equity, the excess, and any further losses applicable to the minority, is 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.

BCZ161 In 2005 the Board decided that this treatment was inconsistent with its conclusion that non-controlling interests are part of the equity of the group, and proposed that an entity should attribute total comprehensive income applicable to non-controlling interests to those interests, even if this results in the non-controlling interests having a deficit balance.

BCZ162 If the parent enters into an arrangement that places it under an obligation to the subsidiary or to the non-controlling interests, the Board believes that the entity should account for that arrangement separately and the arrangement should not affect how the entity attributes comprehensive income to the controlling and non-controlling interests.

BCZ163 Some respondents to the 2005 exposure draft agreed with the proposal, noting that non-controlling interests share proportionately in the risks and rewards of the subsidiary and that the proposal was consistent with the classification of non-controlling interests as equity.

BCZ164 Other respondents disagreed, often on the grounds that controlling and non-controlling interests have different characteristics and should not be treated the same way. They argued that there was no need to change the guidance in IAS 27 (as revised in 2003) (ie that an entity should allocate excess losses to the controlling interest unless the non-controlling interests have a binding obligation and are able to make an additional investment to cover the losses). The reasons given by those respondents were:

(a) The non-controlling interests are not compelled to cover the deficit (unless they have specifically agreed to do so) and it is reasonable to assume that, if the subsidiary requires additional capital in order to continue operations, the non-controlling interests would abandon their investments. In contrast, respondents asserted that in practice the controlling interest often has an implicit obligation to maintain the subsidiary as a going concern.

(b) Often guarantees or other support arrangements by the parent protect the non-controlling interests from losses of the subsidiary in excess of equity and do not affect the way losses are attributed to the controlling and non-controlling interests. Respondents argued that allocating those losses to the parent and non-controlling interests and recognising separately a guarantee would not reflect the underlying economics, which are that only the parent absorbs the losses of the subsidiary. In their view, it would be misleading for financial statements to imply that the non-controlling interests have an obligation to make additional investments.

(c) Recognising guarantees separately is contrary to the principle of the non-recognition of transactions between owners.

(d) Loss allocation should take into account legal, regulatory or contractual constraints, some of which may prevent entities from recognising negative non-controlling interests, especially for regulated businesses (eg banks and insurers).

BCZ165 The Board considered these reasons but observed that, although it is true that non-controlling interests have no further obligation to contribute assets to the subsidiary, neither does the parent. Non-controlling interests participate proportionally in the risks and rewards of an investment in the subsidiary.

BCZ166 Some respondents asked the Board to provide guidance on the accounting for guarantees and similar arrangements between the parent and the subsidiary or the non-controlling interests. They also suggested that the Board should require additional disclosures about inter-company guarantees and the extent of deficits, if any, of non-controlling interests.

BCZ167 The Board considered these requests but observed that this was an issue wider than negative non-controlling interests. For example, the parent is not necessarily responsible for the liabilities of a subsidiary, and often there are factors that restrict the ability of a parent to move assets in a group, which means that the assets of the group are not necessarily freely available to the parent. The Board decided that it would be more appropriate to address comprehensively disclosures about non-controlling interests (disclosures about non-controlling interests are included in IFRS 12).

Changes in ownership interests in subsidiaries (2008 amendments)

BCZ168 The Board decided that after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners). This means that no gain or loss from these changes should be recognised in profit or loss. It also means that no change in the carrying amounts of the subsidiary's assets (including goodwill) or liabilities should be recognised as a result of such transactions.

BCZ169 The Board reached this conclusion because it believed that the approach adopted in the amendments was consistent with its previous decision that non-controlling interests are a separate component of equity (see paragraphs BCZ156–BCZ159).

BCZ170 Some respondents agreed that non-controlling interests are equity but said that they should be treated as a special class of equity. Others disagreed with the requirement because in their view recognising transactions with non-controlling interests as equity transactions would mean that the Board had adopted an entity approach whereas they preferred a proprietary approach. The Board disagreed with this characterisation of the accounting treatment, noting that the accounting proposed was a consequence of classifying non-controlling interests as equity. The Board did not consider comprehensively the entity and proprietary approaches as part of the amendments to IAS 27 in 2008.

BCZ171 Many respondents to the 2005 exposure draft suggested alternative approaches for the accounting for changes in controlling ownership interests. The most commonly suggested alternative would result in increases in controlling ownership interests giving rise to the recognition of additional goodwill, measured as the excess of the purchase consideration over the carrying amount of the separately identified assets in the subsidiary attributable to the additional interest acquired.

BCZ172 Some respondents suggested that when an entity reduces its ownership interest in a subsidiary, without losing control, it should recognise a gain or loss attributable to the controlling interest. They would measure that gain or loss as the difference between the consideration received and the proportion of the carrying amount of the subsidiary's assets (including recognised goodwill) attributable to the ownership interest being disposed of. Respondents supporting this alternative said that it would provide relevant information about the gains and losses attributable to the controlling interest arising on the partial disposal of ownership interests in subsidiaries.

BCZ173 The Board rejected this alternative. Recognising a change in any of the assets of the business, including goodwill, was inconsistent with the Board's decision in IFRS 3 *Business Combinations* (as revised in 2008) that obtaining control in a business combination is a significant economic event. That event causes the initial recognition and measurement of all the assets acquired and liabilities assumed in the business combination. Subsequent transactions with owners should not affect the measurement of those assets and liabilities.

BCZ174 The parent already controls the assets of the business, although it must share the income from those assets with the non-controlling interests. By acquiring the non-controlling interests the parent is obtaining the rights to some, or all, of the income to which the non-controlling interests previously had rights. Generally, the wealth-generating ability of those assets is unaffected by the acquisition of the non-controlling interests. That is to say, the parent is not investing in more or new assets. It is acquiring more rights to the income from the assets it already controls.

BCZ175 By acquiring some, or all, of the non-controlling interests the parent will be allocated a greater proportion of the profits or losses of the subsidiary in periods after the additional interests are acquired. The adjustment to the controlling interest will be equal to the unrecognised share of the value changes that the parent will be allocated when those value changes are recognised by the subsidiary. Failure to make that adjustment will cause the controlling interest to be overstated.

BCZ176 The Board noted that accounting for changes in controlling ownership interests as equity transactions, as well as ensuring that the income of the group and the reported controlling interests are faithfully represented, is less complex than the other alternatives considered.

BCZ177 Some respondents disagreed with the proposal because they were concerned about the effect on reported equity of the subsequent acquisition of non-controlling interests by the parent. They seemed to be particularly concerned about the effect on the reported leverage of an entity that acquires non-controlling interests and whether this might, for example, cause those entities to have to renegotiate loan agreements.

BCZ178 The Board observed that all acquisitions of an entity's equity reduce the entity's equity, regardless of whether it is an acquisition of the parent's ordinary or preference shares or non-controlling interests. Hence, the treatment of a subsequent acquisition of non-controlling interests is consistent with the general accounting for the acquisition by an entity of instruments classified as equity.

BCZ179 The Board understands the importance of providing owners of the parent with information about the total changes in their reported equity. Therefore, the Board decided to require entities to present in a separate schedule the effects of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control on the equity attributable to owners of the parent (this disclosure requirement is now in IFRS 12).

Loss of control (2008 amendments)

BCZ180 A parent loses control of a subsidiary when it loses the power to govern the financial and operating policies of an investee so as to obtain benefit from its activities. Loss of control can result from the sale of an ownership interest or by other means, such as when a subsidiary issues new ownership interests to third parties. Loss of control can also occur in the absence of a transaction. It may, for example, occur on the expiry of an agreement that previously allowed an entity to control a subsidiary.

BCZ181 On loss of control, the parent-subsidiary relationship ceases to exist. The parent no longer controls the subsidiary's individual assets and liabilities. Therefore, the parent derecognises the individual assets, liabilities and equity related to that subsidiary. Equity includes any non-controlling interests as well as amounts previously recognised in other comprehensive income in relation to, for example, foreign currency translation.

BCZ182 The Board decided that any investment the parent has in the former subsidiary after control is lost should be measured at fair value at the date that control is lost and that any resulting gain or loss should be recognised in profit or loss. Some respondents disagreed with that decision. They asserted that the principles for revenue and gain recognition in the *Framework* would not be satisfied for the retained interest. The Board disagreed with those respondents. Measuring the investment at fair value reflected the Board's view that the loss of control of a subsidiary is a significant economic event. The parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship. Therefore, the new investor-investee relationship is recognised and measured initially at the date when control is lost.

BCZ183 The Board decided that the loss of control of a subsidiary is, from the group's perspective, the loss of control over some of the group's individual assets and liabilities. Accordingly, the general requirements in IFRSs should be applied in accounting for the derecognition from the group's financial statements of the subsidiary's assets and liabilities. If a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the separate disposal of those assets and liabilities, the parent reclassifies the gain or loss from equity to profit or loss on the indirect disposal of those assets and liabilities through loss of control of a subsidiary.

BCZ184 The Board also discussed the accounting when an entity transfers its shares in a subsidiary to its own shareholders with the result that the entity loses control of the subsidiary (commonly referred to as a spin-off). The International Financial Reporting Interpretations Committee had previously discussed this matter, but decided not to add the matter to its agenda while the business combinations project was in progress. The Board observed that the issue was outside the scope of the business combinations project. Therefore, the Board decided not to address the measurement basis of distributions to owners in the amendments to IAS 27.

Multiple arrangements

BCZ185 The Board considered whether its decision that a gain or loss on the disposal of a subsidiary should be recognised only when that disposal results in a loss of control could give rise to opportunities to structure transactions to achieve a particular accounting outcome. For example, would an entity be motivated to structure a transaction or arrangement as multiple steps to maximise gains or minimise losses if an entity were planning to dispose of its controlling interest in a subsidiary? Consider the following example. Entity P controls 70 per cent of entity S. Entity P intends to sell all of its 70 per cent controlling interest in entity S. Entity P could initially sell 19 per cent of its ownership interest in entity S without loss of control and then, soon afterwards, sell the remaining 51 per cent and lose control. Alternatively, entity P could sell all of its 70 per cent interest in entity S in one transaction. In the first case, any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration received on the sale of the 19 per cent interest would be recognised directly in equity, whereas the gain or loss from the sale of the remaining 51 per cent interest would be recognised in profit or loss. In the second case, a gain or loss on the sale of the whole 70 per cent interest would be recognised in profit or loss.

BCZ186 The Board noted that the opportunity to conceal losses through structuring would be reduced by the requirements of IAS 36 *Impairment of Assets* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Paragraph 12 of IAS 36 includes significant changes to how an entity uses or expects to use an asset as one of the indicators that the asset might be impaired.

BCZ187 Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of IAS 36 and is accounted for in accordance with IFRS 5. In accordance with paragraph 20 of IFRS 5 'an entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell…'. Therefore, if appropriate, an impairment loss would be recognised for the goodwill and non-current assets of a subsidiary that will be sold or otherwise disposed of before control of the subsidiary is lost. Accordingly, the Board concluded that the principal risk is the minimising of gains, which entities are unlikely to strive to do.

BCZ188 The Board decided that the possibility of such structuring could be overcome by requiring entities to consider whether multiple arrangements should be accounted for as a single transaction to ensure that the principle of faithful representation is adhered to. The Board believes that all the terms and conditions of the arrangements and their economic effects should be considered in determining whether multiple arrangements should be accounted for as a single arrangement. Accordingly, the Board included indicators in paragraph 33 of IAS 27 (as revised in 2008) to assist in identifying when multiple arrangements that result in the loss of control of a subsidiary should be treated as a single arrangement (those indicators are now in paragraph B97 of IFRS 10).

BCZ189 Some respondents disagreed with the indicators that were provided in the exposure draft. They said that the need for guidance on when multiple arrangements should be accounted for as a single arrangement indicates a conceptual weakness in the accounting model developed in the exposure draft. Moreover, such guidance would be unnecessary under other alternatives for accounting for decreases in ownership interests. The Board acknowledges that guidance on multiple arrangements would be unnecessary under some other accounting alternatives. However, the Board does not accept that this means that those models are conceptually superior.

BCZ190 Some respondents suggested that IAS 27 should include examples rather than indicators for when multiple transactions should be treated as a single transaction or arrangement, but that those examples should not be regarded as a complete list. The Board considered that suggestion, but decided to confirm the indicators that were proposed in the exposure draft. The Board believed that the indicators could be applied to a variety of situations and were preferable to providing what could be an endless list of examples to try to capture every possible arrangement.

Effective date and transition

Effective date

BC191 The Board decided to align the effective date for the IFRS with the effective date for IFRS 11, IFRS 12, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. When making this decision, the Board noted that the five IFRSs all deal with the assessment of, and related accounting and disclosure requirements about, a reporting entity's special relationships with other entities (ie when the reporting entity has control or joint control of, or significant influence over, another entity). As a result, the Board concluded that applying IFRS 10 without also applying the other four IFRSs could cause unwarranted confusion.

BC192 The Board usually sets an effective date of between twelve and eighteen months after issuing an IFRS. When deciding the effective date for those IFRSs, the Board considered the following factors:

(a) the time that many countries require for translation and for introducing the mandatory requirements into law.

(b) the consolidation project was related to the global financial crisis that started in 2007 and was accelerated by the Board in response to urgent requests from the leaders of the G20, the Financial Stability Board, users of financial statements, regulators and others to improve the accounting and disclosure of an entity's 'off balance sheet' activities.

(c) the comments received from respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 regarding implementation costs, effective date and transition requirements of the IFRSs to be issued in 2011. Most respondents did not identify the consolidation and joint arrangements IFRSs as having a high impact in terms of the time and resources that their implementation would require. In addition, only a few respondents commented that the effective dates of those IFRSs should be aligned with those of the other IFRSs to be issued in 2011.

BC193 With these factors in mind, the Board decided to require entities to apply the five IFRSs for annual periods beginning on or after 1 January 2013.

BC194 The majority of the respondents to the Request for Views supported early application of the IFRSs to be issued in 2011. Respondents stressed that early application was especially important for first-time adopters in 2011 and 2012. The Board was persuaded by these arguments and decided to permit early application of IFRS 10 but only if an entity applies it in conjunction with the other IFRSs (ie IFRS 11, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011)) to avoid a lack of comparability among financial statements, and for the reasons noted in paragraph BC191 that triggered the Board's decision to set the same effective date for all five IFRSs. Even though an entity should apply the five IFRSs at the same time, the Board noted that an entity should not be prevented from applying any of the disclosure requirements of IFRS 12 early if by doing so users gained a better understanding of the entity's relationships with other entities.

Transition

BC195 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users because the information presented for all periods is comparable.

BC196 In reaching its conclusions, the Board observed that IFRS 10 might result in an investor consolidating investees that were not previously consolidated or not consolidating investees that were previously consolidated. If an investor is required to consolidate a previously unconsolidated investee and has been accounting for its investment in that investee using proportionate consolidation or the equity method, the Board noted that the investor would often have the information available to consolidate the investee retrospectively as if IFRS 10 had always been in place. This is also likely to be the case if an investor no longer consolidates an investee that it previously consolidated but would now have to account for its investment in the investee using the equity method.

BC197 However, the Board acknowledged that retrospective application of IFRS 10 may not be practicable in some circumstances. If an investor on initial application of IFRS 10 consolidates an investee it previously did not consolidate and it is impracticable to apply the provisions of IFRS 10 retrospectively, the reporting entity would apply the acquisition method in IFRS 3 with the acquisition date being the beginning of the earliest period for which application of those requirements is practicable (goodwill would not be recognised for an investee that is not a business).

BC198 If an investor on initial application of IFRS 10 ceases to consolidate an investee that was previously consolidated, the investor measures its retained interest in the investee on the date of initial application, at the amount at which the interest would have been measured if the requirements of IFRS 10 had been effective when the investor first became involved with, or lost control of, the investee. If measurement of the retained interest is impracticable, the investor would apply the requirements in IFRS 10 for accounting for a loss of control at the beginning of the earliest period for which application of those requirements is practicable. The earliest period may be the current period.

BC199 As stated in paragraph BC192, respondents to the Request for Views also commented on the transition requirements of the IFRSs to be issued in 2011. In relation to the transition requirements relating to consolidation, the Board noted that the majority of the respondents to the Request for Views had agreed with limited retrospective application for IFRS 10.

Transitional provisions (2008 amendments)

BCZ200 To improve the comparability of financial information across entities, amendments to IFRSs are usually applied retrospectively. Therefore, the Board proposed in its 2005 exposure draft to require retrospective application of the amendments to IAS 27, on the basis that the benefits of retrospective application outweigh the costs. However, in that exposure draft the Board identified two circumstances in which it concluded that retrospective application would be impracticable:

(a) accounting for increases in a parent's ownership interest in a subsidiary that occurred before the effective date of the amendments. Therefore, the accounting for any previous increase in a parent's ownership interest in a subsidiary before the effective date of the amendments should not be adjusted.

(b) accounting for a parent's investment in a former subsidiary for which control was lost before the effective date of the amendments. Therefore, the carrying amount of any investment in a former subsidiary should not be adjusted to its fair value on the date when control was lost. In addition, an entity should not recalculate any gain or loss on loss of control of a subsidiary if the loss of control occurred before the effective date of the amendments.

BCZ201 The Board concluded that the implementation difficulties and costs associated with applying the amendments retrospectively in these circumstances outweigh the benefits of improved comparability of financial information. Therefore, the Board decided to require prospective application. In addition, the Board concluded that identifying those provisions for which retrospective application of the amendments would be impracticable, and thus prospective application would be required, would reduce implementation costs and result in greater comparability between entities.

BCZ202 Some respondents were concerned that the transitional provisions were different for increases and decreases in ownership interests. They argued that accounting for decreases in non-controlling interests retrospectively imposes compliance costs that are not justifiable, mainly because the requirement to account for increases prospectively reduces comparability anyway. The Board accepted those arguments and decided that prospective application would be required for all changes in ownership interests (those transitional provisions are now in Appendix C of IFRS 10). The revised transitional provisions will lead to increases and decreases in ownership interests being treated symmetrically and the recasting of financial statements being limited to disclosure and presentation. The recognition and measurement of previous transactions will not be changed upon transition.

BCZ203 In response to practical concerns raised by respondents, the Board also decided to require prospective application of the requirement to allocate losses in excess of the non-controlling interests in the equity of a subsidiary to the non-controlling interests, even if that would result in the non-controlling interests being reported as a deficit balance (this transitional provision is now in Appendix C of IFRS 10).

Withdrawal of IAS 27 (2008) and SIC-12

BC204 IFRS 10 identifies the principle of control and determines how to identify whether an investor controls an investee and therefore should consolidate the investee. IFRS 10 also identifies the principles for preparation of consolidated financial statements. IFRS 10 supersedes the requirements related to consolidated financial statements in IAS 27 (as amended in 2008) and SIC-12.

BC205 IFRS 10 does not address the accounting for investments in subsidiaries, jointly controlled entities and associates in separate financial statements as specified in IAS 27. The parts of IAS 27 that relate to separate financial statements have been included in the amended IAS 27.

Summary of main changes from ED 10

BC206 The main changes made by IFRS 10 from the exposure draft ED 10 published in 2008 are:

(a) IFRS 10 includes application guidance on all the following topics:

(i) the meaning of 'power', 'activities' and 'returns' within the definition of control.

(ii) when assessing control of an investee:

- understanding the purpose and design of an investee.
- different activities of an investee that significantly affect the investee's returns.
- a discussion of rights that give an investor power and protective rights.
- power to direct the activities of an investee without a majority of the voting rights, including potential voting rights.
- contractual and non-contractual agency relationships.

(b) IFRS 10 requires retrospective application of its requirements subject to the practicability exemption in IAS 8. The exposure draft had proposed prospective application using the requirements of IFRS 3 or the requirements relating to the loss of control on the date of first applying the IFRS.

Cost-benefit considerations

BC207 The objective of general purpose financial reporting is to provide information about the financial position, performance and changes in financial position of an investee that is useful to a wide range of users in making economic decisions. To attain this objective, the Board seeks to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs of implementing a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC208 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considered the following:

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

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

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

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

(e) the costs of transition for users, preparers and others.

BC209 The Board observed that IFRS 10 will improve the usefulness of consolidated financial statements by developing a single basis for consolidation (control) and robust guidance for applying that basis to situations in which it has proved difficult to assess control in practice and divergence has evolved. IFRS 10 introduces a definition of control of an investee that is applied consistently when assessing whether an investor should consolidate an investee, irrespective of the nature of the investee. IFRS 10 also requires retrospective application of the requirements subject to the practicability exemptions in IAS 8 that will result in comparable information for all periods presented.

BC210 Users prefer information that is comparable from reporting period to reporting period for an individual entity and between different entities in a particular reporting period. The Board concluded that IFRS 10 provides much clearer principles that underlie the definition of control of an investee and provides more application guidance when assessing control than the requirements it replaces. As a consequence, users should have more comparable and verifiable information about the activities controlled by the reporting entity.

BC211 If the requirements in an IFRS are not clear, or there is no guidance, the preparer will often have to seek independent advice and engage with its auditors to resolve uncertainty about how to account for a particular type of transaction. These costs should decrease if the requirements in the revised IFRS are clearer. Accordingly, because IFRS 10 addresses the concerns conveyed to the Board about the absence of guidance in IAS 27 and SIC-12, the Board concluded that preparers will benefit from the new requirements. The Board accepts that any new IFRS will cause preparers to incur one-off costs associated with learning the new requirements and reassessing their accounting. However, the Board's assessment is that the benefits from providing clearer principles and more application guidance outweigh those costs.

BC212 The changes to the definition of control will inevitably lead to some reporting entities consolidating some entities that were previously not consolidated and ceasing consolidation of some entities, or both. The Board does not think it is appropriate to consider whether there will be 'more or less consolidation' by applying the new proposals. However, the clarifications in relation to less than a majority of the voting rights will lead to more consolidation. In the case of what SIC-12 referred to as special purpose entities, the Board believes that the new requirements will result in more appropriate consolidation.

BC213 Given the benefits for users and preparers noted in paragraphs BC209–BC211 the Board believes that the benefits of IFRS 10 outweigh the costs.

BC214 This project also considered disclosure requirements in relation to consolidation. Those requirements, and the related costs and benefits, are assessed in the Basis for Conclusions on IFRS 12.

Dissenting opinions

Dissent of Tatsumi Yamada from IAS 27 (as revised in 2003)

Cross-references have been updated.

DO1 Mr Yamada dissents from this Standard because he believes that the change in classification of minority interests in the consolidated balance sheet, that is to say, the requirement that it be shown as equity, should not be made as part of the Improvements project. He agrees that minority interests do not meet the definition of a liability under the *Framework for the Preparation and Presentation of Financial Statements*,* as stated in paragraph BCZ158 of the Basis for Conclusions, and that the current requirement, for minority interests to be presented separately from liabilities and the parent shareholders' equity, is not desirable. However, he does not believe that this requirement should be altered at this stage. He believes that before making the change in classification, which will have a wide variety of impacts on current consolidation practices, various issues related to this change need to be considered comprehensively by the Board. These include consideration of the objectives of consolidated financial statements and the accounting procedures that should flow from those objectives. Even though the Board concluded as noted in paragraph BC27, he believes that the decision related to the classification of minority interests should not be made until such a comprehensive consideration of recognition and measurement is completed.†

DO2 Traditionally, there are two views of the objectives of consolidated financial statements; they are implicit in the parent company view and the economic entity view. Mr Yamada believes that the objectives, that is to say, what information should be provided and to whom, should be considered by the Board before it makes its decision on the classification of minority interests in IAS 27. He is of the view that the Board is taking the economic entity view without giving enough consideration to this fundamental issue.

DO3 Step acquisitions are being discussed in the second phase of the Business Combinations project, which is not yet finalised at the time of finalising IAS 27 under the Improvements project. When the ownership interest of the parent increases, the Board has tentatively decided that the difference between the consideration paid by the parent to minority interests and the carrying value of the ownership interests acquired by the parent is recognised as part of equity, which is different from the current practice of recognising a change in the amount of goodwill. If the parent retains control of a subsidiary but its ownership interest decreases, the difference between the consideration received by the parent and the carrying value of the ownership interests transferred is also recognised as part of equity, which is different from the current practice of recognising a gain or a loss. Mr Yamada believes that the results of this discussion are predetermined by the decision related to the classification of minority interests as equity. The changes in accounting treatments

* IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

† Paragraph BC27 of IAS 27 (as revised in 2003) was deleted as part of the amendments to IAS 27 in 2008. The paragraph stated:

> The Board acknowledged that this decision gives rise to questions about the recognition and measurement of minority interests but it concluded that the proposed presentation is consistent with current standards and the *Framework* and would provide better comparability than presentation in the consolidated balance sheet with either liabilities or parent shareholders' equity. It decided that the recognition and measurement questions should be addressed as part of its project on business combinations.

are fundamental and he believes that the decision on which of the two views should govern the consolidated financial statements should be taken only after careful consideration of the ramifications. He believes that the amendment of IAS 27 relating to the classification of minority interests should not be made before completion of the second phase of the Business Combinations project.

Dissent of Philippe Danjou, Jan Engström, Robert P Garnett, Gilbert Gélard and Tatsumi Yamada from the amendments to IAS 27 issued in January 2008 on the accounting for non-controlling interests and the loss of control of a subsidiary

Cross-references have been updated.

DO1 Messrs Danjou, Engström, Garnett, Gélard and Yamada dissent from the 2008 amendments to IAS 27.

Accounting for changes in ownership interests in a subsidiary

DO2 Messrs Danjou, Engström, Gélard and Yamada do not agree that acquisitions of non-controlling interests in a subsidiary by the parent should be accounted for in full as equity transactions.

DO3 Those Board members observe that the consideration paid for an additional interest in a subsidiary will reflect the additional interest's share in:

(a) the carrying amount of the subsidiary's net assets at that date;

(b) additionally acquired goodwill; and

(c) unrecognised increases in the fair value of the subsidiary's net assets (including goodwill) since the date when control was obtained.

DO4 Paragraphs 23 and B96 of IFRS 10 require such a transaction to be accounted for as an equity transaction, by adjusting the relative interests of the parent and the non-controlling interests. As a consequence, the additionally acquired goodwill and any unrecognised increases in the fair value of the subsidiary's net assets would be deducted from equity. Those Board members disagree that such accounting faithfully represents the economics of such a transaction.

DO5 Those Board members believe that an increase in ownership interests in a subsidiary is likely to provide additional benefits to the parent. Although control has already been obtained, a higher ownership interest might increase synergies accruing to the parent, for example, by meeting legal thresholds provided in company law, which would give the parent an additional level of discretion over the subsidiary. If the additional ownership interest has been acquired in an arm's length exchange transaction in which knowledgeable, willing parties exchange equal values, these additional benefits are reflected in the purchase price of the additional ownership interest. Those Board members believe that the acquisition of non-controlling interests by the parent should give rise to the recognition of goodwill, measured as the excess of the consideration transferred over the carrying amount of the subsidiary's net assets attributable to the additional interest acquired. Those Board members acknowledge that this amount also includes unrecognised increases in the fair value of the subsidiary's net assets since the date when control was obtained. However, on the basis of cost-benefit considerations, they believe that it is a reasonable approximation of the additionally acquired goodwill.

DO6 Messrs Danjou, Gélard and Yamada agree that, in conformity with the *Framework for the Preparation and Presentation of Financial Statements*,* non-controlling interests should be presented within the group's equity, because they are not liabilities. However, they believe that until the debates over the objectives of consolidated financial statements (ie what information should be provided and to whom) and the definition of the reporting entity have been settled at the conceptual level, transactions between the parent and non-controlling interests should not be accounted for in the same manner as transactions in which the parent entity acquires its own shares and reduces its equity. In their view, non-controlling interests cannot be considered equivalent to the ordinary ownership interests of the owners of the parent. The owners of the parent and the holders of non-controlling interests in a subsidiary do not share the same risks and rewards in relation to the group's operations and net assets because ownership interests in a subsidiary share only the risks and rewards associated with that subsidiary.

DO7 In addition, Messrs Danjou and Gélard observe that IFRS 3 *Business Combinations* (as revised in 2008) provides an option to measure non-controlling interests in a business combination as their proportionate share of the acquiree's net identifiable assets rather than at their fair value. However, paragraph BC207 of the Basis for Conclusions on IFRS 3 (as revised in 2008) states that accounting for the non-controlling interests at fair value is conceptually superior to this alternative measurement. This view implies that the subsidiary's portion of goodwill attributable to the non-controlling interests at the date when control was obtained is an asset at that date and there is no conceptual reason for it no longer to be an asset at the time of any subsequent acquisitions of non-controlling interests.

DO8 Mr Garnett disagrees with the treatment of changes in controlling interests in subsidiaries after control is established (paragraphs BCZ168–BCZ179 of the Basis for Conclusions). He believes that it is important that the consequences of such changes for the owners of the parent entity are reported clearly in the financial statements.

DO9 Mr Garnett believes that the amendments to IAS 27 adopt the economic entity approach that treats all equity interests in the group as being homogeneous. Transactions between controlling and non-controlling interests are regarded as mere transfers within the total equity interest and no gain or loss is recognised on such transactions. Mr Garnett observes that the non-controlling interests represent equity claims that are restricted to particular subsidiaries, whereas the controlling interests are affected by the performance of the entire group. The consolidated financial statements should therefore report performance from the perspective of the controlling interest (a parent entity perspective) in addition to the wider perspective provided by the economic entity approach. This implies the recognition of additional goodwill on purchases, and gains or losses on disposals of the parent entity's interest in a subsidiary.

DO10 If, as Mr Garnett would prefer, the full goodwill method were not used (see paragraphs DO7–DO10 of the dissenting views on IFRS 3), the acquisition of an additional interest in a subsidiary would give rise to the recognition of additional purchased goodwill, measured as the excess of the consideration transferred over the carrying amount of the subsidiary's net assets attributable to the additional interest acquired.

* IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

DO11 Mr Garnett does not agree with the requirement in paragraph B96 of this IFRS that, in respect of a partial disposal of the parent's ownership interest in a subsidiary that does not result in a loss of control, the carrying amount of the non-controlling interests should be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. On the contrary, he believes that the carrying amount of the non-controlling interests should be adjusted by the fair value of the consideration paid by the non-controlling interests to acquire that additional interest.

DO12 Mr Garnett also believes that it is important to provide the owners of the parent entity with information about the effects of a partial disposal of holdings in subsidiaries, including the difference between the fair value of the consideration received and the proportion of the carrying amount of the subsidiary's assets (including purchased goodwill) attributable to the disposal.

Loss of control

DO13 Mr Garnett disagrees with the requirement in paragraph B98 of this IFRS that if a parent loses control of a subsidiary, it measures any retained investment in the former subsidiary at fair value and any difference between the carrying amount of the retained investment and its fair value is recognised in profit or loss, because the retained investment was not part of the exchange. The loss of control of a subsidiary is a significant economic event that warrants deconsolidation. However, the retained investment has not been sold. Under current IFRSs, gains and losses on cost method, available-for-sale and equity method investments are recognised in profit or loss only when the investment is sold (other than impairment). Mr Garnett would have recognised the effect of measuring the retained investment at fair value as a separate component of other comprehensive income instead of profit or loss.

Accounting for losses attributable to non-controlling interests

DO14 Mr Danjou disagrees with paragraph B94 of this IFRS according to which losses can be attributed without limitation to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

DO15 In many circumstances, in the absence of any commitment or binding obligation of the non-controlling interests to make an additional investment to cover the excess losses of the subsidiary, the continuation of the operations of a subsidiary will be funded through the contribution of additional capital by the parent and with the non-controlling interests being diluted. In those circumstances, the deficit balance attributable to the non-controlling interests that would result from the amendment in paragraph B94 does not present faithfully the equity of the consolidating entity.

DO16 Mr Danjou believes that the Standard should therefore not preclude the allocation against the parent equity of losses that exceed the non-controlling interests in a consolidated subsidiary when the facts and circumstances are as outlined in paragraph DO15.

Appendix

Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 10 and the related amendments to other IFRSs. Amended footnotes are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

BCA1 In paragraph BC23(b) 'special purpose entities' is footnoted as follows:

* SIC-12 *Consolidation—Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no longer specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

In paragraph BC58A 'IAS 39' is footnoted as follows:

* The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements for separate financial statements were not changed.

In paragraph BC58M 'BC66J' is footnoted as follows:

* renumbered to paragraphs 12 and BC16–BC22 when IAS 27 was amended in May 2011.

The footnote to paragraph BC60 is amended as follows:

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

IFRS 2 *Share-based Payment*

BCA2 Paragraph BC22E is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The definition of control changed but the definition of a group was not substantially changed.

IFRS 3 *Business Combinations*

BCA3 In paragraph BC93 'parent-subsidiary relationship' is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded, and the definition of control was revised, by IFRS 10 *Consolidated Financial Statements* issued in May 2011.

Paragraph BC218 is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The requirements with respect to transactions between owners in their capacity as owners did not change.

In paragraph BC430 'acquisition date' is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The requirements for the subsequent accounting for an acquiree in consolidated financial statements were not changed.

In paragraph BC431 'as soon as it is published' is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The requirements for the accounting for changes in controlling ownership interests were not changed.

IFRS 4 *Insurance Contracts*

BCA4 The footnote to paragraph BC7(a) is amended as follows:

* The Board completed the second phase of its project on business combinations in 2008 by issuing a revised IFRS 3 *Business Combinations* and an amended version of IAS 27 *Consolidated and Separate Financial Statements*. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011.

In paragraph BC131 the first sentence is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011, but the accounting policy requirements were not changed.

The footnote to 'minority interests' in paragraph BC164 is amended as follows:

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

BCA5 In paragraph BC24B 'until control is lost' is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded, and the definition of control was consequently revised, by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The requirement to consolidate a subsidiary until control is lost did not change.

Paragraph BC53 is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. IFRS 10 does not contain an exception from consolidation for subsidiaries acquired and held exclusively with a view to resale.

Paragraph BC79A is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. Paragraph 45(c) in IAS 27 was moved to paragraph C6(c) of IFRS 10; however, the transition provisions were not changed.

IFRS 8 *Operating Segments*

BCA6 The footnote to 'minority interest' in paragraph BC23 is amended as follows:

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. <u>The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.</u>

IFRS 9 *Financial Instruments* (as issued at October 2010)

BCA7 Paragraph BCZ3.15 is footnoted as follows:

* SIC-12 *Consolidation—Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no longer specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

IAS 1 *Presentation of Financial Statements*

BCA8 The footnote to paragraph BC4(e) is amended as follows:

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

The footnote to the heading above paragraph BC59 is amended as follows:

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

IAS 19 *Employee Benefits*

BCA9 Paragraph BC10E is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The criteria for the exemption from preparing consolidated financial statements were not changed.

In paragraph BC68D(f) 'and should consolidate' is footnoted as follows:

* SIC-12 *Consolidation—Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no longer specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

IAS 21 *The Effects of Changes in Foreign Exchange Rates*

BCA10 The footnote to the heading above paragraph BC33 is amended as follows:

* This heading and paragraphs BC33 and BC34 were added as a consequence of amendments to IAS 27 *Consolidated and Separate Financial Statements* made as part of the second phase of the business combinations project in 2008. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements did not change.

Paragraph BC35 is footnoted as follows:

* The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements for dividends were not changed.

IAS 24 *Related Party Disclosures*

BCA11 Paragraph BC49(b) is footnoted as follows:

* The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The definition of separate financial statements was not changed.

IAS 32 *Financial Instruments: Presentation*

BCA12 In paragraph BC49(h) the footnote to 'minority interest' is amended as follows:

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. <u>The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.</u>

IAS 36 *Impairment of Assets*

BCA13 In paragraph BC2 the reference to 'IAS 27 *Consolidated and Separate Financial Statements*' is footnoted as follows:

* The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011.

IAS 39 *Financial Instruments: Recognition and Measurement* (as amended at September 2010)

BCA14 Paragraph BC55 is footnoted as follows:

* SIC-12 *Consolidation—Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no longer specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

IFRIC 4 *Determining whether an Arrangement contains a Lease*

BCA15 Paragraph BC25 is footnoted as follows:

* SIC-12 *Consolidation—Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no longer specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

BCA16 In paragraph BC2 ‘interpretative guidance’ is footnoted as follows:

* The consolidation requirements in IAS 27 and SIC-12 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011.

IFRIC 17 *Distributions of Non-cash Assets to Owners*

BCA17 Paragraph BC13 is footnoted as follows:

* The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements for transactions between owners did not change.

Amendments to guidance on other IFRSs

The following amendments to guidance on IFRSs are necessary in order to ensure consistency with IFRS 10 and the related amendments to other IFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

IGA1 The heading above paragraph IG26 and paragraph IG26 are amended as follows:

~~IAS 27~~ IFRS 10 *Consolidated ~~and Separate~~ Financial Statements*

IG26 A first-time adopter consolidates all subsidiaries (as defined in ~~IAS 27~~ IFRS 10), unless ~~IAS 27~~ IFRS 10 requires otherwise.

IFRS 4 *Insurance Contracts*

IGA2 In paragraph IG2 the 'Treatment in phase 1' entry for contract type 1.28 is amended as follows:

If the entities present individual or separate financial statements, they treat the contract as an insurance contract in those individual or separate financial statements (see IAS 27 *~~Consolidated and~~ Separate Financial Statements*). …

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

IGA3 The paragraph above example 13 is amended as follows:

A subsidiary acquired with a view to sale is not exempt from consolidation in accordance with ~~IAS 27~~ IFRS 10 *Consolidated ~~and Separate~~ Financial Statements*. However, …

IAS 39 *Financial Instruments: Recognition and Measurement*

IGA4 The answers to Questions F.1.4 and F.1.6 are amended as follows:

F.1.4 Yes, if the derivative contracts are internal to the entity being reported on. … The principles of preparing consolidated financial statements in ~~IAS 27.24~~ paragraph B86 of IFRS 10 *Consolidated Financial Statements* require ~~that~~ a parent to 'eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows' ~~'intragroup balances, transactions, income and expenses shall be eliminated in full'~~.

…

F.1.6 It depends. ~~IAS 27~~ IFRS 10 requires all internal transactions to be eliminated in consolidated financial statements. As stated in …

IFRIC 17 *Distributions of Non-cash Assets to Owners*

IGA5 Paragraph IE4 is amended as follows:

IE4 However, if Company A distributes to its shareholders shares of Subsidiary B representing only a non-controlling interest in Subsidiary B and retains control of Subsidiary B, the transaction is not within the scope of the Interpretation. Company A accounts for the distribution in accordance with ~~IAS 27~~ IFRS 10 *Consolidated ~~and Separate~~ Financial Statements* ~~(as amended in 2008)~~. Company A controls Company B both before and after the transaction.

HKFRS 11
Issued June 2011

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 11

Joint Arrangements

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

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Hong Kong Financial Reporting Standard 11 *Joint Arrangements* (HKFRS 11) is set out in paragraphs 1–27 and Appendices A–D. 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 Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 11 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Overview

IN1 Hong Kong Financial Reporting Standard 11 *Joint Arrangements* establishes principles for financial reporting by parties to a joint arrangement.

IN2 The HKFRS supersedes HKAS 31 *Interests in Joint Ventures* and HK(SIC)-Int 13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers* and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Reasons for issuing the HKFRS

IN3 The HKFRS is concerned principally with addressing two aspects of HKAS 31: first, that the structure of the arrangement was the only determinant of the accounting and, second, that an entity had a choice of accounting treatment for interests in jointly controlled entities.

IN4 HKFRS 11 improves on HKAS 31 by establishing principles that are applicable to the accounting for all joint arrangements.

Main features of the HKFRS

IN5 The HKFRS requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations arising from the arrangement.

General requirements

IN6 The HKFRS is to be applied by all entities that are a party to a joint arrangement. A joint arrangement is an arrangement of which two or more parties have joint control. The HKFRS defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (ie activities that significantly affect the returns of the arrangement) require the unanimous consent of the parties sharing control.

IN7 The HKFRS classifies joint arrangements into two types—joint operations and joint ventures. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint venturers) have rights to the net assets of the arrangement.

IN8 An entity determines the type of joint arrangement in which it is involved by considering its rights and obligations. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the contractual terms agreed to by the parties to the arrangement and, when relevant, other facts and circumstances.

IN9 The HKFRS requires a joint operator to recognise and measure the assets and liabilities (and recognise the related revenues and expenses) in relation to its interest in the arrangement in accordance with relevant HKFRSs applicable to the particular assets, liabilities, revenues and expenses.

IN10 The HKFRS requires a joint venturer to recognise an investment and to account for that investment using the equity method in accordance with HKAS 28 *Investments in Associates and Joint Ventures*, unless the entity is exempted from applying the equity method as specified in that standard.

IN11 The disclosure requirements for parties with joint control of a joint arrangement are specified in HKFRS 12 *Disclosure of Interests in Other Entities*.

Hong Kong Financial Reporting Standard 11
Joint Arrangements

Objective

1 **The objective of this HKFRS is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (ie *joint arrangements*).**

Meeting the objective

2 To meet the objective in paragraph 1, this HKFRS defines *joint control* and requires an entity that is a *party to a joint arrangement* to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

Scope

3 **This HKFRS shall be applied by all entities that are a party to a joint arrangement.**

Joint arrangements

4 **A joint arrangement is an arrangement of which two or more parties have joint control.**

5 **A joint arrangement has the following characteristics:**

(a) The parties are bound by a contractual arrangement (see paragraphs B2–B4).

(b) The contractual arrangement gives two or more of those parties joint control of the arrangement (see paragraphs 7–13).

6 **A joint arrangement is either a *joint operation* or a *joint venture*.**

Joint control

7 **Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.**

8 An entity that is a party to an arrangement shall assess whether the contractual arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities).

9 Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.

10 In a joint arrangement, no single party controls the arrangement on its own. A party with joint control of an arrangement can prevent any of the other parties, or a group of the parties, from controlling the arrangement.

11 An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This HKFRS distinguishes between parties that have joint control of a joint arrangement (*joint operators* or *joint venturers*) and parties that participate in, but do not have joint control of, a joint arrangement.

12 An entity will need to apply judgement when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances (see paragraphs B5–B11).

13 If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.

Types of joint arrangement

14 An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.

15 A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

16 A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

17 An entity applies judgement when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances (see paragraphs B12–B33).

18 Sometimes the parties are bound by a framework agreement that sets up the general contractual terms for undertaking one or more activities. The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might be different if the parties' rights and obligations differ when undertaking the different activities dealt with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities that form part of the same framework agreement.

19 If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed.

Financial statements of parties to a joint arrangement

Joint operations

20 A joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly.

21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the HKFRSs applicable to the particular assets, liabilities, revenues and expenses.

22 The accounting for transactions such as the sale, contribution or purchase of assets between an entity and a joint operation in which it is a joint operator is specified in paragraphs B34–B37.

23 A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 20–22 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation. If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the HKFRSs applicable to that interest.

Joint ventures

24 A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with HKAS 28 *Investments in Associates and Joint Ventures* unless the entity is exempted from applying the equity method as specified in that standard.

25 A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with HKFRS 9 *Financial Instruments*, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with HKAS 28 (as amended in 2011).

Separate financial statements

26 **In its separate financial statements, a joint operator or joint venturer shall account for its interest in:**

(a) a joint operation in accordance with paragraphs 20–22;

(b) a joint venture in accordance with paragraph 10 of HKAS 27 *Separate Financial Statements*.

27 **In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:**

(a) a joint operation in accordance with paragraph 23;

(b) a joint venture in accordance with HKFRS 9, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 10 of HKAS 27 (as amended in 2011).

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

joint arrangement	An arrangement of which two or more parties have **joint control**.
joint control	The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
joint operation	A **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.
joint operator	A party to a **joint operation** that has **joint control** of that joint operation.
joint venture	A **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights to the net assets of the arrangement.
joint venturer	A party to a **joint venture** that has **joint control** of that joint venture.
party to a joint arrangement	An entity that participates in a **joint arrangement**, regardless of whether that entity has **joint control** of the arrangement.
separate vehicle	A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

The following terms are defined in HKAS 27 (as amended in 2011), HKAS 28 (as amended in 2011) or HKFRS 10 *Consolidated Financial Statements* and are used in this HKFRS with the meanings specified in those HKFRSs:

- control of an investee
- equity method
- power
- protective rights
- relevant activities
- separate financial statements
- significant influence.

Appendix B
Application guidance

This appendix is an integral part of the HKFRS. It describes the application of paragraphs 1–27 and has the same authority as the other parts of the HKFRS.

B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying HKFRS 11.

Joint arrangements

Contractual arrangement (paragraph 5)

B2 Contractual arrangements can be evidenced in several ways. An enforceable contractual arrangement is often, but not always, in writing, usually in the form of a contract or documented discussions between the parties. Statutory mechanisms can also create enforceable arrangements, either on their own or in conjunction with contracts between the parties.

B3 When joint arrangements are structured through a *separate vehicle* (see paragraphs B19–B33), the contractual arrangement, or some aspects of the contractual arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.

B4 The contractual arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The contractual arrangement generally deals with such matters as:

(a) the purpose, activity and duration of the joint arrangement.

(b) how the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.

(c) the decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-making process reflected in the contractual arrangement establishes joint control of the arrangement (see paragraphs B5–B11).

(d) the capital or other contributions required of the parties.

(e) how the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

Joint control (paragraphs 7–13)

B5 In assessing whether an entity has joint control of an arrangement, an entity shall assess first whether all the parties, or a group of the parties, control the arrangement. HKFRS 10 defines control and shall be used to determine whether all the parties, or a group of the parties, are exposed, or have rights, to variable returns from their involvement with the arrangement and have the ability to affect those returns through their power over the arrangement. When all the parties, or a group of the parties, considered collectively, are able to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities), the parties control the arrangement collectively.

B6 After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. Assessing whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of its parties alone, can require judgement.

B7 Sometimes the decision-making process that is agreed upon by the parties in their contractual arrangement implicitly leads to joint control. For example, assume two parties establish an arrangement in which each has 50 per cent of the voting rights and the contractual arrangement between them specifies that at least 51 per cent of the voting rights are required to make decisions about the relevant activities. In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

B8 In other circumstances, the contractual arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the contractual arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement.

Application examples

Example 1

Assume that three parties establish an arrangement: A has 50 per cent of the voting rights in the arrangement, B has 30 per cent and C has 20 per cent. The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing.

Example 2

Assume an arrangement has three parties: A has 50 per cent of the voting rights in the arrangement and B and C each have 25 per cent. The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of either B or C. In this example, A, B and C collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75 per cent of the voting rights (ie either A and B or A and C). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

continued…

…continued

Application examples

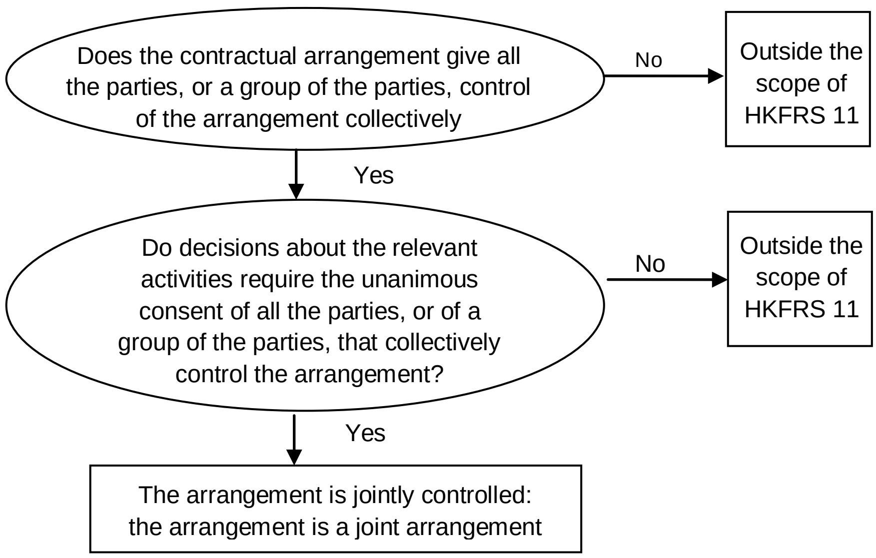
Example 3

Assume an arrangement in which A and B each have 35 per cent of the voting rights in the arrangement with the remaining 30 per cent being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. A and B have joint control of the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both A and B agreeing.

B9 The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. If the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement.

B10 A contractual arrangement might include clauses on the resolution of disputes, such as arbitration. These provisions may allow for decisions to be made in the absence of unanimous consent among the parties that have joint control. The existence of such provisions does not prevent the arrangement from being jointly controlled and, consequently, from being a joint arrangement.

Assessing joint control



B11 When an arrangement is outside the scope of HKFRS 11, an entity accounts for its interest in the arrangement in accordance with relevant HKFRSs, such as HKFRS 10, HKAS 28 (as amended in 2011) or HKFRS 9.

Types of joint arrangement (paragraphs 14–19)

B12 Joint arrangements are established for a variety of purposes (eg as a way for parties to share costs and risks, or as a way to provide the parties with access to new technology or new markets), and can be established using different structures and legal forms.

B13 Some arrangements do not require the activity that is the subject of the arrangement to be undertaken in a separate vehicle. However, other arrangements involve the establishment of a separate vehicle.

B14 The classification of joint arrangements required by this HKFRS depends upon the parties' rights and obligations arising from the arrangement in the normal course of business. This HKFRS classifies joint arrangements as either joint operations or joint ventures. When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. When an entity has rights to the net assets of the arrangement, the arrangement is a joint venture. Paragraphs B16–B33 set out the assessment an entity carries out to determine whether it has an interest in a joint operation or an interest in a joint venture.

Classification of a joint arrangement

B15 As stated in paragraph B14, the classification of joint arrangements requires the parties to assess their rights and obligations arising from the arrangement. When making that assessment, an entity shall consider the following:

(a) the structure of the joint arrangement (see paragraphs B16–B21).

(b) when the joint arrangement is structured through a separate vehicle:

- (i) the legal form of the separate vehicle (see paragraphs B22–B24);
- (ii) the terms of the contractual arrangement (see paragraphs B25–B28); and
- (iii) when relevant, other facts and circumstances (see paragraphs B29–B33).

Structure of the joint arrangement

Joint arrangements not structured through a separate vehicle

B16 A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses.

B17 The contractual arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties intend to undertake those activities together. For example, the parties to a joint arrangement could agree to manufacture a product together, with each party being responsible for a specific task and each using its own assets and incurring its own liabilities. The contractual arrangement could also specify how the revenues and expenses that are common to the parties are to be shared among them. In such a case, each joint operator recognises in its financial statements the assets and liabilities used for the specific task, and recognises its share of the revenues and expenses in accordance with the contractual arrangement.

B18 In other cases, the parties to a joint arrangement might agree, for example, to share and operate an asset together. In such a case, the contractual arrangement establishes the parties' rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each joint operator accounts for its share of the joint asset and its agreed share of any liabilities, and recognises its share of the output, revenues and expenses in accordance with the contractual arrangement.

Joint arrangements structured through a separate vehicle

B19 A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.

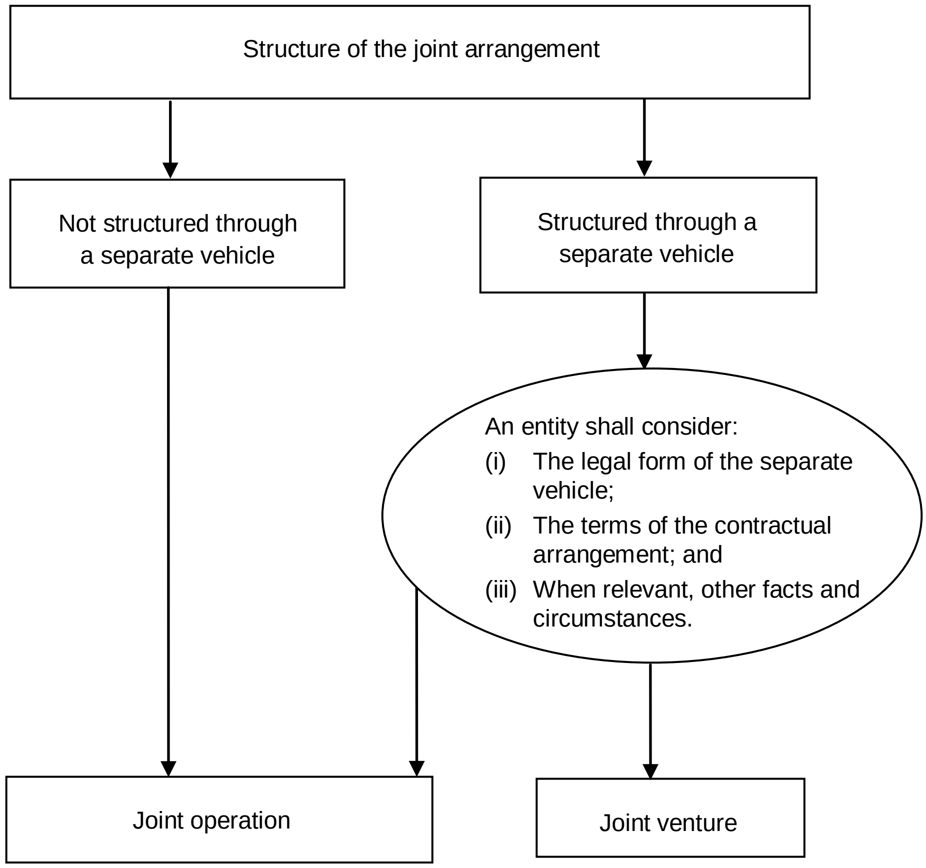
B20 Whether a party is a joint operator or a joint venturer depends on the party's rights to the assets, and obligations for the liabilities, relating to the arrangement that are held in the separate vehicle.

B21 As stated in paragraph B15, when the parties have structured a joint arrangement in a separate vehicle, the parties need to assess whether the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, any other facts and circumstances give them:

(a) rights to the assets, and obligations for the liabilities, relating to the arrangement (ie the arrangement is a joint operation); or

(b) rights to the net assets of the arrangement (ie the arrangement is a joint venture).

Classification of a joint arrangement: assessment of the parties' rights and obligations arising from the arrangement



The legal form of the separate vehicle

B22 The legal form of the separate vehicle is relevant when assessing the type of joint arrangement. The legal form assists in the initial assessment of the parties' rights to the assets and obligations for the liabilities held in the separate vehicle, such as whether the parties have interests in the assets held in the separate vehicle and whether they are liable for the liabilities held in the separate vehicle.

B23 For example, the parties might conduct the joint arrangement through a separate vehicle, whose legal form causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the arrangement is a joint venture. However, the terms agreed by the parties in their contractual arrangement (see paragraphs B25–B28) and, when relevant, other facts and circumstances (see paragraphs B29–B33) can override the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle.

B24 The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the parties conduct the joint arrangement in a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (ie the assets and liabilities held in the separate vehicle are the parties' assets and liabilities).

Assessing the terms of the contractual arrangement

B25 In many cases, the rights and obligations agreed to by the parties in their contractual arrangements are consistent, or do not conflict, with the rights and obligations conferred on the parties by the legal form of the separate vehicle in which the arrangement has been structured.

B26 In other cases, the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured.

Application example

Example 4

Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity. In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement.

However, the parties modify the features of the corporation through their contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion. Such contractual modifications to the features of a corporation can cause an arrangement to be a joint operation.

B27 The following table compares common terms in contractual arrangements of parties to a joint operation and common terms in contractual arrangements of parties to a joint venture. The examples of the contractual terms provided in the following table are not exhaustive.

<table>
<tr><th colspan="3">Assessing the terms of the contractual arrangement</th></tr>
<tr><th></th><th>Joint operation</th><th>Joint venture</th></tr>
<tr><td>The terms of the contractual arrangement</td><td>The contractual arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.</td><td>The contractual arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (ie it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities, relating to the arrangement).</td></tr>
<tr><td>Rights to assets</td><td>The contractual arrangement establishes that the parties to the joint arrangement share all interests (eg rights, title or ownership) in the assets relating to the arrangement in a specified proportion (eg in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).</td><td>The contractual arrangement establishes that the assets brought into the arrangement or subsequently acquired by the joint arrangement are the arrangement's assets. The parties have no interests (ie no rights, title or ownership) in the assets of the arrangement.</td></tr>
<tr><td rowspan="2">Obligations for liabilities</td><td rowspan="2">The contractual arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion (eg in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).</td><td>The contractual arrangement establishes that the joint arrangement is liable for the debts and obligations of the arrangement.</td></tr>
<tr><td>The contractual arrangement establishes that the parties to the joint arrangement are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both.</td></tr>
</table>

Assessing the terms of the contractual arrangement		
	Joint operation	**Joint venture**
	The contractual arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	The contractual arrangement states that creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.
Revenues, expenses, profit or loss	The contractual arrangement establishes the allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement. For example, the contractual arrangement might establish that revenues and expenses are allocated on the basis of the capacity that each party uses in a plant operated jointly, which could differ from their ownership interest in the joint arrangement. In other instances, the parties might have agreed to share the profit or loss relating to the arrangement on the basis of a specified proportion such as the parties' ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement establishes each party's share in the profit or loss relating to the activities of the arrangement.
Guarantees	The parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (for some of which the parties might or might not have provided a guarantee).	

B28 When the contractual arrangement specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, they are parties to a joint operation and do not need to consider other facts and circumstances (paragraphs B29–B33) for the purposes of classifying the joint arrangement.

Assessing other facts and circumstances

B29 When the terms of the contractual arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

B30 A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The contractual terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This will be the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

B31 When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.

B32 The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

Application example

Example 5

Assume that two parties structure a joint arrangement in an incorporated entity (entity C) in which each party has a 50 per cent ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties.

The legal form of entity C (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity C are the assets and liabilities of entity C. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity C. Accordingly, the legal form of entity C and the terms of the contractual arrangement indicate that the arrangement is a joint venture.

continued…

…continued

Application examples

However, the parties also consider the following aspects of the arrangement:

- The parties agreed to purchase all the output produced by entity C in a ratio of 50:50. Entity C cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.

- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by entity C. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

From the fact pattern above, the following facts and circumstances are relevant:

- The obligation of the parties to purchase all the output produced by entity C reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of entity C.

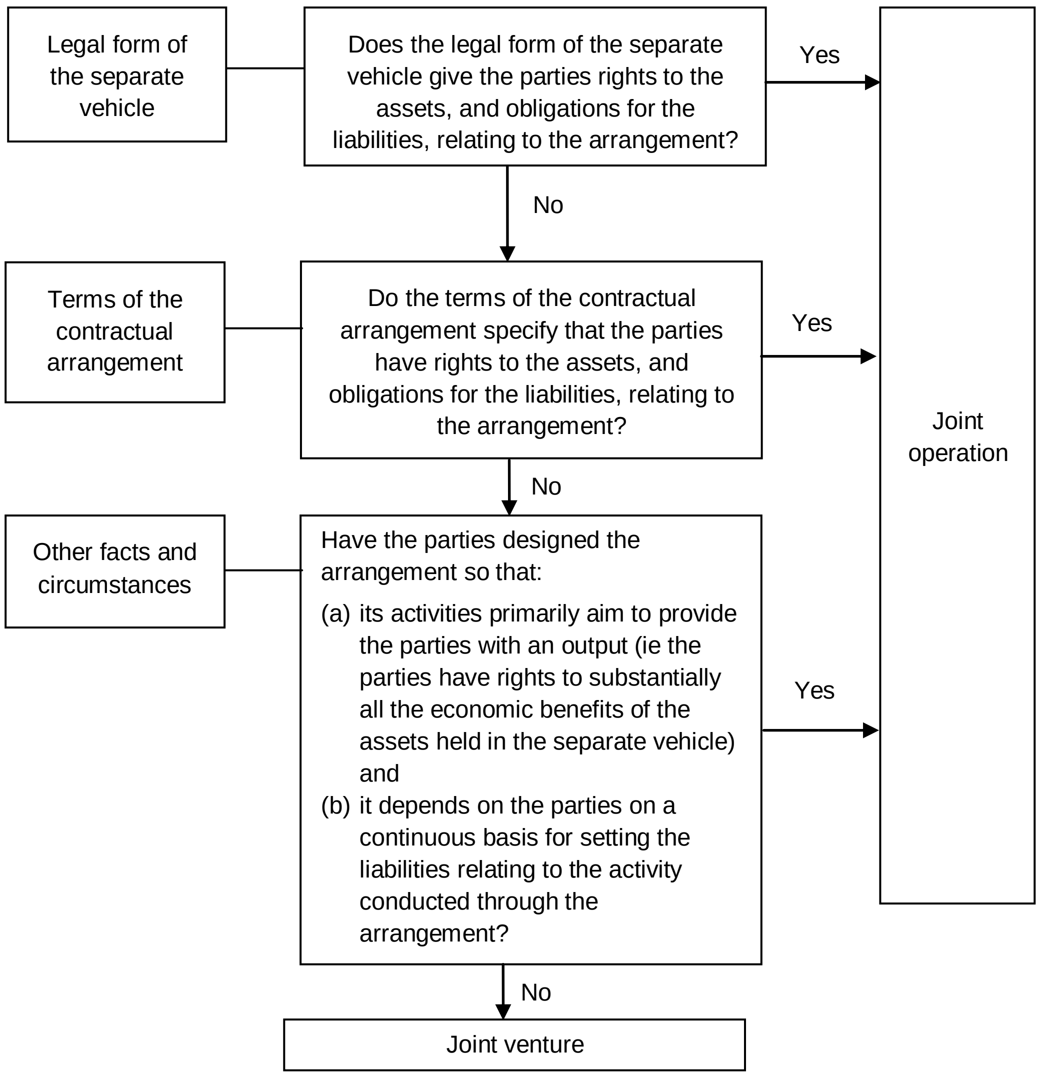
- The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity C.

These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in entity C assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

B33 The following flow chart reflects the assessment an entity follows to classify an arrangement when the joint arrangement is structured through a separate vehicle:

Classification of a joint arrangement structured through a separate vehicle



Financial statements of parties to a joint arrangement (paragraph 22)

Accounting for sales or contributions of assets to a joint operation

B34 When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.

B35 When such transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognised fully by the joint operator.

Accounting for purchases of assets from a joint operation

B36 When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a purchase of assets, it shall not recognise its share of the gains and losses until it resells those assets to a third party.

B37 When such transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognise its share of those losses.

Appendix C
Effective date, transition and withdrawal of other HKFRSs

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

Effective date

C1 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this HKFRS earlier, it shall disclose that fact and apply HKFRS 10, HKFRS 12 *Disclosure of Interests in Other Entities*, HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) at the same time.

Transition

Joint ventures—transition from proportionate consolidation to the equity method

C2 When changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture as at the beginning of the earliest period presented. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged.

C3 The opening balance of the investment determined in accordance with paragraph C2 is regarded as the deemed cost of the investment at initial recognition. An entity shall apply paragraphs 40–43 of HKAS 28 (as amended in 2011) to the opening balance of the investment to assess whether the investment is impaired and shall recognise any impairment loss as an adjustment to retained earnings at the beginning of the earliest period presented. The initial recognition exception in paragraphs 15 and 24 of HKAS 12 *Income Taxes* does not apply when the entity recognises an investment in a joint venture resulting from applying the transition requirements for joint ventures that had previously been proportionately consolidated.

C4 If aggregating all previously proportionately consolidated assets and liabilities results in negative net assets, an entity shall assess whether it has legal or constructive obligations in relation to the negative net assets and, if so, the entity shall recognise the corresponding liability. If the entity concludes that it does not have legal or constructive obligations in relation to the negative net assets, it shall not recognise the corresponding liability but it shall adjust retained earnings at the beginning of the earliest period presented. The entity shall disclose this fact, along with its cumulative unrecognised share of losses of its joint ventures as at the beginning of the earliest period presented and at the date at which this HKFRS is first applied.

C5 An entity shall disclose a breakdown of the assets and liabilities that have been aggregated into the single line investment balance as at the beginning of the earliest period presented. That disclosure shall be prepared in an aggregated manner for all joint ventures for which an entity applies the transition requirements referred to in paragraphs C2–C6.

C6 After initial recognition, an entity shall account for its investment in the joint venture using the equity method in accordance with HKAS 28 (as amended in 2011).

Joint operations—transition from the equity method to accounting for assets and liabilities

C7 When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity shall, at the beginning of the earliest period presented, derecognise the investment that was previously accounted for using the equity method and any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 38 of HKAS 28 (as amended in 2011) and recognise its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.

C8 An entity shall determine its interest in the assets and liabilities relating to the joint operation on the basis of its rights and obligations in a specified proportion in accordance with the contractual arrangement. An entity measures the initial carrying amounts of the assets and liabilities by disaggregating them from the carrying amount of the investment at the beginning of the earliest period presented on the basis of the information used by the entity in applying the equity method.

C9 Any difference arising from the investment previously accounted for using the equity method together with any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 38 of HKAS 28 (as amended in 2011), and the net amount of the assets and liabilities, including any goodwill, recognised shall be:

(a) offset against any goodwill relating to the investment with any remaining difference adjusted against retained earnings at the beginning of the earliest period presented, if the net amount of the assets and liabilities, including any goodwill, recognised is higher than the investment (and any other items that formed part of the entity's net investment) derecognised.

(b) adjusted against retained earnings at the beginning of the earliest period presented, if the net amount of the assets and liabilities, including any goodwill, recognised is lower than the investment (and any other items that formed part of the entity's net investment) derecognised.

C10 An entity changing from the equity method to accounting for assets and liabilities shall provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted against retained earnings, at the beginning of the earliest period presented.

C11 The initial recognition exception in paragraphs 15 and 24 of HKAS 12 does not apply when the entity recognises assets and liabilities relating to its interest in a joint operation.

Transition provisions in an entity's separate financial statements

C12 An entity that, in accordance with paragraph 10 of HKAS 27, was previously accounting in its separate financial statements for its interest in a joint operation as an investment at cost or in accordance with HKFRS 9 shall:

(a) derecognise the investment and recognise the assets and the liabilities in respect of its interest in the joint operation at the amounts determined in accordance with paragraphs C7–C9.

(b) provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted in retained earnings, at the beginning of the earliest period presented.

C13 The initial recognition exception in paragraphs 15 and 24 of HKAS 12 does not apply when the entity recognises assets and liabilities relating to its interest in a joint operation in its separate financial statements resulting from applying the transition requirements for joint operations referred to in paragraph C12.

References to HKFRS 9

C14 If an entity applies this HKFRS but does not yet apply HKFRS 9, any reference to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*.

Withdrawal of other HKFRSs

C15 This HKFRS supersedes the following HKFRSs:

(a) HKAS 31 *Interests in Joint Ventures*; and

(b) HK(SIC)-Int 13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*.

Appendix D

Amendments to other HKFRSs

This appendix sets out amendments to other HKFRSs that are a consequence of issuing HKFRS 11. An entity shall apply the amendments for annual periods beginning on or after 1 January 2013. If an entity applies HKFRS 11 for an earlier period, it shall apply the amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

D1 This table shows how the following references have been amended in other HKFRSs.

<table>
<tr><th>Existing reference to</th><th>contained in</th><th>in</th><th>is amended to reference to</th></tr>
<tr><td rowspan="5">HKAS 31 Interests in Joint Ventures</td><td>HKFRS 2</td><td>paragraph 5</td><td rowspan="5">HKFRS 11 Joint Arrangements</td></tr>
<tr><td>HKFRS 9 (issued November 2010)</td><td>paragraph B4.3.12(c)</td></tr>
<tr><td>HKAS 36</td><td>paragraph 4(c)</td></tr>
<tr><td>HK(IFRIC)-Int 5</td><td>References</td></tr>
<tr><td>HK(IFRIC)-Int 9</td><td>paragraph 5(c)</td></tr>
<tr><td rowspan="3">HKAS 28 Investments in Associates</td><td>HKAS 18</td><td>paragraph 6(b)</td><td rowspan="3">HKAS 28 Investments in Associates and Joint Ventures</td></tr>
<tr><td>HKAS 36</td><td>paragraph 4(b)</td></tr>
<tr><td>HK(IFRIC)-Int 5</td><td>References</td></tr>
<tr><td>joint control over</td><td>HKAS 24</td><td>Paragraph 9(a)(i) and 11(b)</td><td>joint control of</td></tr>
<tr><td rowspan="2">jointly controlled entity(ies)</td><td>HKFRS 1</td><td>heading before paragraph 31, paragraphs 31 and D1(g), heading before paragraph D14, paragraphs D14 and D15</td><td rowspan="2">joint venture(s)</td></tr>
<tr><td>HKAS 36</td><td>heading before paragraph 12(h) and paragraphs 12(h) and 12(h)(ii)</td></tr>
<tr><td rowspan="2">joint venture(s)</td><td>HKAS 12</td><td>paragraphs 2, 15, 18(e), 24, heading before paragraph 38, paragraphs 38, 38(a), 44, 45, 81(f), 87 and 87C</td><td rowspan="2">joint arrangement(s)</td></tr>
<tr><td>HKAS 21</td><td>definition of ‘foreign operation’ in paragraph 8 and paragraphs 11 and 18</td></tr>
<tr><td>venturer(s)</td><td>HKAS 24</td><td>paragraphs 11(b) and 19(e)</td><td>joint venturer(s)</td></tr>
</table>

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

D2 Paragraph 39I is added as follows:

39I HKFRS 10 *Consolidated Financial Statements* and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 31, B7, C1, D1, D14 and D15 and added paragraph D31. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D3 Paragraph D1 is amended as follows:

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

(a) …

(p) extinguishing financial liabilities with equity instruments (paragraph D25); ~~and~~

(q) severe hyperinflation (paragraphs D26–D30)~~.~~ ; and

(r) joint arrangements (paragraph D31).

D4 After paragraph D30, a heading and paragraph D31 are added.

Joint arrangements

D31 A first-time adopter may apply the transition provisions in HKFRS 11 with the following exception. When changing from proportionate consolidation to the equity method, a first-time adopter shall test for impairment the investment in accordance with HKAS 36 as at the beginning of the earliest period presented, regardless of whether there is any indication that the investment may be impaired. Any resulting impairment shall be recognised as an adjustment to retained earnings at the beginning of the earliest period presented.

HKFRS 2 *Share-based Payment*

D5 Paragraph 63A is added as follows:

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

HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

D6 Paragraph 28 is amended as follows:

28 The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss [footnote omitted] from continuing operations in the period in which the criteria in paragraphs 7–9 are no longer met. Financial statements for the periods since classification as held for sale shall be amended accordingly if the disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary,

joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate. The entity shall present that adjustment in the same caption in the statement of comprehensive income used to present a gain or loss, if any, recognised in accordance with paragraph 37.

D7 Paragraph 44G is added as follows:

44G HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 28. An entity shall apply that amendment when it applies HKFRS 11.

HKFRS 7 *Financial Instruments: Disclosures*

D8 Paragraph 3(a) is amended as follows:

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; in those cases, …

D9 Paragraph 44O is added as follows:

44O HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 3. An entity shall apply that amendment when it applies HKFRS 10 and HKFRS 11.

HKFRS 9 *Financial Instruments* (as issued in November 2009)

D10 Paragraph 8.1.2 is added as follows:

8.1.2 HKFRS 10 *Consolidated Financial Statements* and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph C8 and deleted paragraphs C18–C23 and the related headings. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D11 In Appendix C, in paragraph C8, the amendments to paragraph 3(a) of HKFRS 7 *Financial Instruments: Disclosures* are amended as follows:

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39 and HKFRS 9; in those cases, …

D12 The heading above paragraph C20 and paragraphs C20 and C21 are deleted.

D13 The heading above paragraph C22 and paragraphs C22 and C23 are deleted.

HKFRS 9 *Financial Instruments* (as issued in November 2010)

D14 Paragraph 7.1.2 is added as follows:

7.1.2 HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 3.2.1, B3.2.1–B3.2.3, B4.3.12(c), B5.7.15, C11 and C30 and deleted paragraphs C23–C28 and the related headings. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

D15 In Appendix C, in paragraph C11, the amendments to paragraph 3(a) of HKFRS 7 *Financial Instruments: Disclosures* are amended as follows:

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ or HKAS 28 *Investments in Associates* *and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, …

D16 The heading above paragraph C25 and paragraphs C25 and C26 are deleted.

D17 The heading above paragraph C27 and paragraphs C27 and C28 are deleted.

D18 In paragraph C30, the amendments to paragraph 4(a) of HKAS 32 *Financial Instruments: Presentation* are amended as follows:

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements* or HKAS 28 *Investments in Associates* *and Joint Ventures* ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27 or HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, …

HKAS 7 *Statement of Cash Flows*

D19 In the rubric, 'paragraphs 1–56' is amended to 'paragraphs 1–57'.

D20 Paragraphs 37 and 38 are amended as follows:

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

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

D21 Paragraph 50(b) is deleted.

D22 Paragraph 57 is added as follows:

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

HKAS 12 *Income Taxes*

D23 [Not used]

D24 Paragraph IN6(a) is amended as follows:

(a) the parent, investor, ~~or~~ joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

D25 Paragraph 39 is amended as follows:

39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ~~ventures~~ arrangements, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor, ~~or~~ joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

(b) …

D26 Paragraph 43 is amended as follows:

43 The arrangement between the parties to a joint ~~venture~~ arrangement usually deals with the ~~sharing~~ distribution of the profits and identifies whether decisions on such matters require the consent of all the ~~venturers~~ parties or a ~~specified majority~~ group of the ~~venturers~~ parties. When the joint venturer or joint operator

can control the timing of the distribution of its share of the ~~sharing of~~ profits of the joint arrangement and it is probable that its share of the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

D27 Paragraph 98A is added as follows:

98A HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 2, 15, 18(e), 24, 38, 39, 43–45, 81(f), 87 and 87C. An entity shall apply those amendments when it applies HKFRS 11.

HKAS 18 *Revenue*

D28 In the rubric, 'paragraphs 1–40' is amended to 'paragraphs 1–41'.

D29 Paragraph 41 is added as follows:

41 HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 6(b). An entity shall apply that amendment when it applies HKFRS 11.

HKAS 21 *The Effects of Changes in Foreign Exchange Rates*

D30 Paragraph IN12 is amended as follows:

IN12 The Standard permits an entity to present its financial statements in any currency (or currencies). For this purpose, an entity could be a stand-alone entity, a parent preparing consolidated financial statements or a parent, an investor with joint control of, or significant influence over, an investee ~~or a venturer~~ preparing separate financial statements in accordance with HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*.

D31 In paragraphs 3(b) and 44 'proportionate consolidation,' and in paragraph 33 'proportionately consolidated,' are deleted.

D32 In paragraph 45, 'HKAS 31 *Interests in Joint Ventures*' is deleted.

D33 In paragraph 46 the last sentence is amended as follows:

46 … The same approach is used in applying the equity method to associates and joint ventures ~~and in applying proportionate consolidation to joint ventures~~ in accordance with HKAS 28 ~~*Investments in Associates* and HKAS 31~~ (as amended in 2011).

D34 Paragraph 48A is amended as follows:

48A In addition to the disposal of an entity's entire interest in a foreign operation, the following partial disposals are accounted for as disposals ~~even if the entity retains an interest in the former subsidiary, associate or jointly controlled entity~~:

(a) when the partial disposal involves the loss of control of a subsidiary that includes a foreign operation, regardless of whether the entity retains a non-controlling interest in its former subsidiary after the partial disposal; and

(b) when the retained interest after the partial disposal of an interest in ~~the loss of significant influence over an~~ a joint arrangement or a partial disposal of an interest in an associate that includes a foreign operation is a financial asset that includes a foreign operation. ~~; and~~

(c) ~~the loss of joint control over a jointly controlled entity that includes a foreign operation.~~

D35 Paragraph 60F is added as follows:

60F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 3(b), 8, 11, 18, 19, 33, 44–46 and 48A. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 24 *Related Party Disclosures*

D36 Paragraph 3 is amended as follows:

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

D37 Paragraph 19 is amended as follows:

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

(a) the parent;

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

(c) subsidiaries; ...

D38 Paragraph 25 is amended as follows:

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

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

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

D39 Paragraph 28A is added as follows:

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

HKAS 32 *Financial Instruments: Presentation*

D40 Paragraph 4(a) is amended as follows:

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with <u>HKFRS 10 *Consolidated Financial Statements*,</u> HKAS 27 *~~Consolidated and~~ Separate Financial Statements*~~,~~ <u>or</u> HKAS 28 *Investments in Associates* <u>*and Joint Ventures*</u> ~~or HKAS 31 *Interests in Joint Ventures*~~. However, in some cases, HKAS 27~~,~~ <u>or</u> HKAS 28 ~~or HKAS 31~~ permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; …

D41 Paragraph 97I is added as follows:

97I HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 4(a) and AG29. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 33 *Earnings per Share*

D42 Paragraph 40 and A11 are amended and paragraph 74B is added as follows:

40 A subsidiary, joint venture or associate may issue to parties other than the parent~~, venturer~~ or investor<u>s with joint control of, or significant influence over, the investee</u> potential ordinary shares that are convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent~~,~~ <u>or investors with joint control of, or significant influence</u> (the reporting entity) <u>over, the investee</u> ~~venturer or investor~~. If these potential ordinary shares of the subsidiary, joint venture or associate have a dilutive effect on the basic earnings per share of the reporting entity, they are included in the calculation of diluted earnings per share.

A11 Potential ordinary shares of a subsidiary, joint venture or associate convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent~~,~~ <u>or investors with joint control of, or significant influence</u> (the reporting entity) <u>over, the investee</u> ~~venturer or investor~~ are included in the calculation of diluted earnings per share as follows: …

74B HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 4, 40 and A11. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 36 *Impairment of Assets*

D43 Paragraph 140H is added as follows:

140H HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraph 4, the heading above paragraph 12(h) and paragraph 12(h). An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HKAS 38 *Intangible Assets*

D44 Paragraph 3(e) is amended as follows:

3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:

(a) …

(e) financial assets as defined in HKAS 32. The recognition and measurement of some financial assets are covered by <u>HKFRS 10 *Consolidated Financial Statements,*</u> HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ <u>and</u> HKAS 28 *Investments in Associates* <u>*and Joint Ventures*</u> ~~and HKAS 31~~ ~~*Interests in Joint Ventures*~~.

(f) …

D45 Paragraph 130F is added as follows:

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

HKAS 39 *Financial Instruments: Recognition and Measurement*

D46 Paragraph 2(a) is amended as follows:

2 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for ~~under~~ <u>in accordance with HKFRS 10 *Consolidated Financial Statements,*</u> HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ <u>or</u> HKAS 28 *Investments in Associates* <u>*and Joint Ventures*</u> ~~and HKAS 31~~ ~~*Interests in Joint Ventures*~~. However, entities shall apply this Standard to an interest in a subsidiary, associate or joint venture that according to HKAS 27~~,~~ <u>or</u> HKAS 28 ~~or HKAS 31~~ is accounted for under this Standard. …

D47 Paragraphs AG3 and AG4I(a) are amended as follows:

AG3 Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venturer entity uses HKAS 28 to determine whether the equity method of accounting is appropriate for such an investment. ~~Similarly, the investor entity uses HKAS 31 to determine whether proportionate consolidation or the equity method is appropriate for such an investment.~~ If ~~neither~~ the equity method ~~nor proportionate consolidation~~ is not appropriate, the entity applies this Standard to that strategic investment.

AG4I(a) The entity is a venture capital organisation, mutual fund, unit trust or similar entity whose business is investing in financial assets with a view to profiting from their total return in the form of interest or dividends and changes in fair value. HKAS 28 ~~and HKAS 31~~ allows such investments to be ~~excluded from their scope provided they are~~ measured at fair value through profit or loss in accordance with this Standard. An entity may apply the same accounting policy to other investments managed on a total return basis but over which its influence is insufficient for them to be within the scope of HKAS 28 ~~or HKAS 31~~.

D48 Paragraph 103P is added as follows:

103P HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 2(a), 15, AG3, AG36–AG38 and AG4I(a). An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HK(IFRIC)-Int 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

D49 Paragraphs 8 and 9 are amended as follows:

8 The contributor shall determine whether it has control~~,~~ or joint control of, or significant influence over, the fund by reference to ~~HKAS 27~~ HKFRS 10, HKFRS 11 and HKAS 28~~, HKAS 31 and HK(SIC)-Int-12~~. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.

9 If a contributor does not have control~~,~~ or joint control of, or significant influence over, the fund, the contributor shall recognise the right to receive reimbursement from the fund as a reimbursement in accordance with HKAS 37. This reimbursement shall be measured at the lower of:

(a) ...

D50 Paragraph 14B is added as follows:

14B HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraphs 8 and 9. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

HK(IFRIC)-Int 9 *Reassessment of Embedded Derivatives*

D51 In the rubric, 'paragraphs 1–11' is amended to 'paragraphs 1–12'.

D52 Paragraph 12 is added as follows:

12 HKFRS 11, issued in June 2011, amended paragraph 5(c). An entity shall apply that amendment when it applies HKFRS 11.

HK(IFRIC)-Int 16 *Hedges of a Net Investment in a Foreign Operation*

D53 The footnote to paragraph 2 is amended as follows:

* This will be the case for consolidated financial statements, financial statements in which investments <u>such as associates or joint ventures</u> are accounted for using the equity method~~, financial statements in which venturers' interests in joint ventures are proportionately consolidated (subject to change as proposed in ED 9 *Joint Arrangements* published by the International Accounting Standards Board in September 2007)~~ and financial statements that include a branch <u>or a joint operation as defined in HKFRS 11 *Joint Arrangements*</u>.

Appendix E
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 11.

The International Financial Reporting Standard comparable with HKFRS 11 is IFRS 11 *Joint Arrangements*.

There are no major textual differences between HKFRS 11 and IFRS 11.

HKFRS 11 BC
Issued June 2011

Basis for Conclusions on
Hong Kong Financial Reporting Standard 11

Joint Arrangements

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

Basis for Conclusions on HKFRS 11 *Joint Arrangements*

HKFRS 11 is based on IFRS 11 *Joint Arrangement*. In approving HKFRS 11, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 11. Accordingly, there are no significant differences between HKFRS 11 and IFRS 11. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 11 referred to below generally correspond with those in HKFRS 11.

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Basis for Conclusions on HKFRS 11 *Joint Arrangements*

This Basis for Conclusions accompanies, but is not part of, IFRS 11.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 11 *Joint Arrangements*. Individual Board members gave greater weight to some factors than to others.

BC2 The Board added the joint ventures project to its agenda as part of the project to reduce differences between International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP). The requirements of IFRS 11 were not deliberated by the US Financial Accounting Standards Board (FASB).

BC3 The Board focused its deliberations on enhancing the faithful representation of joint arrangements that an entity provides in its financial statements, by establishing a principle-based approach to accounting for joint arrangements, and by requiring enhanced disclosures. Even though the Board focused its efforts on improving the reporting of joint arrangements, the result is that the requirements of the IFRS achieve closer convergence with US GAAP than did IAS 31 *Interests in Joint Ventures*, which IFRS 11 supersedes.

Objective

BC4 IFRS 11 sets out requirements for the recognition and measurement of an entity's interest in joint arrangements. The requirements for the disclosure of an entity's interest in joint arrangements have been included in IFRS 12 *Disclosure of Interests in Other Entities* (see paragraphs BC52–BC55). IFRS 11 is concerned principally with addressing two aspects of IAS 31 that the Board regarded as impediments to high quality reporting of joint arrangements: first, that the structure of the arrangement was the only determinant of the accounting, and second, that an entity had a choice of accounting treatment for interests in jointly controlled entities.

BC5 The Board did not reconsider all the requirements in IAS 31. For example, the Board did not reconsider the equity method. Accordingly, this Basis for Conclusions does not discuss requirements of IAS 31 that the Board did not reconsider.

BC6 The Board published its proposals in an exposure draft, ED 9 *Joint Arrangements*, in September 2007 with a comment deadline of 11 January 2008. The Board received over 110 comment letters on the exposure draft.

The problems with IAS 31

BC7 IAS 31 established different accounting requirements depending on whether the arrangements were structured through an entity. Jointly controlled operations and jointly controlled assets were arrangements that did not require the establishment of an entity or financial structure that is separate from the parties. IAS 31 required parties to these arrangements to recognise assets, liabilities, revenues and expenses arising from the arrangements. When arrangements were structured through an entity, IAS 31 classified them as jointly controlled entities. Parties with interests in jointly controlled entities accounted for them using proportionate consolidation or, as an alternative, the equity method.

BC8 The problem with basing different accounting requirements solely on the existence of an entity, combined with the choice of accounting treatment for jointly controlled entities, was that some arrangements that gave the parties similar rights and obligations were accounted for differently and, conversely, arrangements that gave the parties different rights and obligations were accounted for similarly. The Board's policy is to exclude options in accounting treatment from accounting standards whenever possible. Such options can lead to similar transactions being accounted for in different ways and, therefore, can impair comparability.

Improving IAS 31 with the principles of IFRS 11

BC9 In the Board's view, the accounting for joint arrangements should reflect the rights and obligations that the parties have as a result of their interests in the arrangements, regardless of those arrangements' structure or legal form. This is the principle that IFRS 11 establishes for parties to a joint arrangement when accounting for their interests in the arrangements. However, the Board acknowledges that sometimes the structure or the legal form of the joint arrangements is decisive in determining the parties' rights and obligations arising from the arrangements and, consequently, in determining the classification of the joint arrangements (see paragraphs BC26 and BC31).

BC10 Entities applying IAS 31 were required to choose the same accounting treatment (ie proportionate consolidation or equity method) when accounting for all of their interests in jointly controlled entities. Applying the same accounting treatment to all the interests that an entity has in different jointly controlled entities might not always lead to the faithful representation of each of those interests. For example, an entity whose policy was to account for all of its interests in jointly controlled entities using proportionate consolidation might have recognised assets and liabilities proportionately even though this did not faithfully represent the entity's rights and obligations in the assets and liabilities of particular joint arrangements. Conversely, an entity might have accounted for all of its interests in jointly controlled entities using the equity method, when the recognition of the entity's rights and obligations in particular joint arrangements would instead have led to the recognition of assets and liabilities.

BC11 The accounting for joint arrangements required by the IFRS is not a function of an entity's accounting policy choice but is, instead, determined by an entity applying the principles of the IFRS to each of its joint arrangements and recognising, as a result, the rights and obligations arising from each of them. The Board concluded that proportionate consolidation is not an appropriate method to account for interests in joint arrangements when the parties have neither rights to the assets, nor obligations for the liabilities, relating to the arrangement. The Board also concluded that the equity method is not an appropriate method to account for interests in joint arrangements when parties have rights to the assets, and obligations for the liabilities, relating to the arrangement. The Board believes that it is misleading for users of financial statements if an entity recognises assets and liabilities for which it does not have rights or obligations, or does not recognise assets and liabilities for which it does have rights and obligations.

BC12 The Board also reconsidered the disclosure requirements in IAS 31 for interests in joint arrangements. The Board believes that the disclosure requirements in IFRS 12 will enable users to gain a better understanding of the nature and extent of an entity's operations undertaken through joint arrangements.

Scope

BC13 The IFRS should be applied by all entities that are a party to a joint arrangement. The IFRS does not change the two essential characteristics that IAS 31 required arrangements to have in order to be deemed 'joint ventures', ie that a contractual arrangement that binds the parties to the arrangement exists, and that the contractual arrangement establishes that two or more of those parties have joint control of the arrangement.

BC14 The Board believes that the new definition of control and the application requirements to assess control in IFRS 10 *Consolidated Financial Statements* will assist entities in determining whether an arrangement is controlled or jointly controlled, and in that respect it might cause entities to reconsider their previous assessment of their relationship with the investee. Despite the changes that these reassessments might cause, the Board believes that arrangements that were within the scope of IAS 31 would generally also be within the scope of IFRS 11.

Scope exception

BC15 The Board reconsidered the scope exception of IAS 31 that had also been proposed in ED 9. The Board concluded that the scope exception in ED 9 for interests in joint ventures held by venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, that are measured at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments*, is more appropriately characterised as a measurement exemption, not as a scope exception.

BC16 The Board observed that when venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, conclude that they have an interest in a joint arrangement, this is because the arrangement has the characteristics of a joint arrangement as specified in IFRS 11 (ie a contractual arrangement exists that establishes that two or more parties have joint control of the arrangement).

BC17 The Board also observed that the scope exception in ED 9 did not relate to the fact that these arrangements do not have the characteristics of joint arrangements, but to the fact that for investments held by venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, fair value measurement provides more useful information for users of the financial statements than would application of the equity method.

BC18 Accordingly, the Board decided to maintain the option that permits such entities to measure their interests in joint ventures at fair value through profit or loss in accordance with IFRS 9, but clarified that this is an exemption from the requirement to measure interests in joint ventures using the equity method, rather than an exception to the scope of IFRS 11 for joint ventures in which these entities have interests.

Joint arrangements

BC19 The Board decided to use the term 'joint arrangement', rather than 'joint venture', to describe arrangements that are subject to the requirements of the IFRS. As noted in paragraph BC13, the IFRS does not change the two essential characteristics that IAS 31 required for arrangements to be 'joint ventures': a contractual arrangement that binds the parties to the arrangement exists, and the contractual arrangement establishes that two or more of those parties have joint control of the arrangement.

Joint control

BC20 In ED 9, the proposed definition of 'joint arrangement' required 'shared decision-making' by all the parties to the arrangement. Some respondents questioned how 'shared decision-making' was intended to operate and how it differed from 'joint control'. The Board introduced the term 'shared decision-making' in the exposure draft instead of 'joint control' because control was defined in IAS 27 *Consolidated and Separate Financial Statements* in the context of having power over the financial and operating policies of an entity.* During its redeliberation of ED 9, the Board concluded that in joint arrangements, it is the activity undertaken by the parties that is the matter over which the parties share control or share decision-making, regardless of whether the activity is conducted in a separate entity. Consequently, the Board concluded that 'joint control' is a term that expresses better than 'shared decision-making' that the control of the activity that is the subject matter of the arrangement is shared among the parties with joint control of the arrangement.

BC21 The Board did not reconsider the concept of 'joint control' as defined in IAS 31 or in ED 9 (ie the requirement of unanimous consent for the decisions that give the parties control of an arrangement). However, the definition of 'joint control' in the IFRS is different from those in IAS 31 and ED 9. The reason for the change is to align the definition of 'joint control' with the definition of 'control' in IFRS 10. IFRS 11 directs parties to an arrangement to assess first whether all the parties, or a group of the parties, control the arrangement collectively, on the basis of the definition of control and corresponding guidance in IFRS 10. Once an entity has concluded that the arrangement is collectively controlled by all the parties, or by a group of the parties, joint control exists only when decisions about the activities that significantly affect the returns of the arrangement (ie the relevant activities) require the unanimous consent of those parties.

BC22 In response to concerns expressed by some respondents who pointed out that, unlike IAS 31, ED 9 did not include the term 'investors in a joint arrangement', the Board clarified during its redeliberation of ED 9 that not all the parties to a joint arrangement need to have joint control for the arrangement to be a joint arrangement. Indeed, some of the parties to a joint arrangement can have joint control whereas others, although able to participate, do not have joint control of the arrangement. The Board decided to use the terms 'joint operators' to designate parties with joint control of a 'joint operation' and 'joint venturers' to designate parties with joint control of a 'joint venture' (see paragraph BC24).

BC23 The Board observed that the parties to a joint arrangement might agree to change or modify the governance and decision-making process of the arrangement at any time. As a result of such a change, a party might gain or lose joint control of the arrangement. Consequently, the Board concluded that if facts and circumstances change, the parties to a joint arrangement should reassess whether they are parties with joint control of the arrangement.

Types of joint arrangement

BC24 The IFRS classifies joint arrangements into two types—'joint operations' and 'joint ventures'. Parties with joint control of a joint operation have rights to the assets, and obligations for the liabilities, relating to the arrangement ('joint operators'), whereas parties with joint control of a joint venture ('joint venturers') have rights to the net assets of the arrangement.

* The consolidation requirements in IAS 27 were replaced by IFRS 10 *Consolidated Financial Statements* issued in 2011 and the definition of control was revised.

BC25 The classification of joint arrangements into two types was considered by the Board in its redeliberation of the exposure draft. ED 9 proposed to classify joint arrangements into three types—'joint operations', 'joint assets' and 'joint ventures'. The Board observed that in some instances it might be difficult to assess whether an arrangement is a 'joint operation' or a 'joint asset'. This is because elements from both types of joint arrangement are sometimes present (in many arrangements joint assets are also jointly operated, and therefore such arrangements could be viewed as a 'joint asset' or as a 'joint operation'). Additionally, both types of joint arrangement result in the same accounting outcome (ie recognition of assets and liabilities and corresponding revenues and expenses). For these reasons, the Board decided to merge 'joint operations' and 'joint assets' into a single type of joint arrangement called 'joint operation'. This decision simplifies the IFRS by aligning the two types of joint arrangement presented by the IFRS (ie 'joint operations' and 'joint ventures') with the two possible accounting outcomes (ie recognition of assets, liabilities, revenues and expenses, or recognition of an investment accounted for using the equity method).

BC26 The Board observed that when the parties do not structure their joint arrangement through a separate vehicle (ie arrangements that were formerly 'jointly controlled operations' and 'jointly controlled assets' in IAS 31), the parties determine in the contractual arrangements their rights to the assets, and their obligations for the liabilities, relating to the arrangement. Such arrangements are joint operations.

BC27 In reaching this conclusion, the Board acknowledged the possibility that parties to a joint arrangement that is not structured through a separate vehicle might establish terms in the contractual arrangement under which the parties have rights only to the net assets of the arrangement. The Board thought that this possibility was likely to be rare and that the benefits of introducing an additional assessment in the classification of joint arrangements when these are not structured through separate vehicles would not outweigh the costs of increasing the complexity of the IFRS. This is because in the vast majority of cases, accounting for joint arrangements that are not structured through separate vehicles on a gross basis leads to the faithful representation of the parties' rights and obligations arising from those arrangements.

BC28 The Board acknowledged that classifying jointly controlled entities in IAS 31 into joint operations or joint ventures in the IFRS requires an entity to assess its rights and obligations arising from these arrangements, which will require the entity to exercise judgement.

BC29 The Board considered whether the definition of a 'business', as defined in IFRS 3 *Business Combinations*, would be helpful in distinguishing between a joint venture and a joint operation. Because a 'business' can be found in all types of joint arrangement, the Board decided not to pursue this approach.

BC30 The Board also concluded that there should not be a rebuttable presumption that the arrangement is a joint venture when it has been structured through a separate vehicle. The Board decided that parties to a joint arrangement that is structured through a separate vehicle should assess the classification of the arrangement by taking into consideration all facts and circumstances. The Board noted that an entity should take into consideration the legal form of the separate vehicle, the terms agreed in the contractual arrangement and, when relevant, any other facts and circumstances.

BC31 In taking this approach, the Board observed that the legal form of the separate vehicle in which the joint arrangement is structured provides an initial indicator of the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement. The exception is when the legal form of the separate vehicle does not confer separation between the parties and the vehicle. In such a case, the Board concluded that the assessment of the rights and obligations conferred upon the parties by the legal form of that separate vehicle would be sufficient to conclude that the arrangement is a joint operation.

BC32 The Board believes that the selection of a particular legal form is in many cases driven by the intended economic substance that the particular legal form delivers. However, the Board observed that in some cases the choice of a particular legal form responds to tax, regulatory requirements or other reasons that can alter the intended economic substance initially sought by the parties to the arrangement. In those instances, the parties might use their contractual arrangements to modify the effects that the legal form of the arrangement would otherwise have on their rights and obligations.

BC33 The Board noted that other facts and circumstances might also affect the rights and obligations of the parties to a joint arrangement and, ultimately, affect the classification of the arrangement. Therefore, the parties should recognise the assets and liabilities relating to an arrangement if the parties designed the arrangement so that its activities primarily aimed to provide the parties with an output (ie the parties are entitled to substantially all the economic benefits of the assets relating to the arrangement) and they are, as a result of the design of the arrangement, obliged to settle the liabilities relating to the arrangement.

BC34 The IFRS defines 'joint ventures' as arrangements whereby the parties that have joint control of the arrangement (ie the joint venturers) have rights to the net assets of the arrangement. The Board observed that the term 'net assets' in the definition of joint ventures aimed to portray that the joint venturers have rights to an investment in the arrangement. However, such a definition (ie 'rights to the net assets of the arrangement') would not prevent a joint venturer from having a net liability position arising from its involvement in the joint venture. This could happen, for example, if the joint venture had incurred losses that had reduced the joint venturer's investment to zero, and as a result of the joint venturer having provided a guarantee to cover any losses that the joint venture might incur, the joint venturer has an obligation for those losses. The Board observed that neither the provision of the guarantee by the joint venturer, nor the liability assumed by the joint venturer as a result of the joint venture incurring losses, determines that the arrangement is a joint operation.

BC35 Many respondents to ED 9 were concerned that joint ventures could be merely 'residuals'. This is because these respondents interpreted joint ventures to mean that after parties had identified rights to individual assets or obligations for expenses or financing, joint ventures would be merely any remaining assets and liabilities of the arrangement. As a result of these concerns, the Board clarified that the unit of account of a joint arrangement is the activity that two or more parties have agreed to control jointly, and that a party should assess its rights to the assets, and obligations for the liabilities, relating to that activity. Consequently, the term 'joint venture' refers to a jointly controlled activity in which the parties have an investment.

BC36 During its redeliberation of ED 9, the Board made it clear that different joint arrangements or different types of joint arrangement can be established beneath the umbrella of a single arrangement or framework agreement to deal with, for example, different activities that are interrelated. The Board also observed the possibility that within the same separate vehicle the parties may undertake different activities in which they have different rights to the assets, and obligations for the liabilities, relating to these different activities resulting in different types of joint arrangement conducted within the same separate vehicle. However, the Board acknowledged that even though this situation is conceptually possible, it would be rare in practice.

BC37 The Board observed that the rights and obligations of parties to joint arrangements might change over time. This might happen, for example, as a result of a change in the purpose of the arrangement that might trigger a reconsideration of the terms of the contractual arrangements. Consequently, the Board concluded that the assessment of the type of joint arrangement needs to be a continuous process, to the extent that facts and circumstances change.

Financial statements of parties to a joint arrangement

Joint operation

BC38 In relation to the accounting for a party's interest in a joint operation, some respondents to ED 9 enquired how proportionate consolidation differed from the recognition of (or recognition of shares of) assets, liabilities, revenues and expenses arising from a joint operation. The Board noted that there are two main differences between recognising assets, liabilities, revenues and expenses relating to the activity of the joint operation and proportionate consolidation. The first difference relates to the fact that the rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenues and expenses relating to a joint operation might differ from its ownership interest in the joint operation. The IFRS requires an entity with an interest in a joint operation to recognise assets, liabilities, revenues and expenses according to the entity's shares in the assets, liabilities, revenues and expenses of the joint operation as determined and specified in the contractual arrangement, rather than basing the recognition of assets, liabilities, revenues and expenses on the ownership interest that the entity has in the joint operation. The second difference from proportionate consolidation is that the parties' interests in a joint operation are recognised in their separate financial statements. Consequently, there is no difference in what is recognised in the parties' separate financial statements and the parties' consolidated financial statements or the parties' financial statements in which investments are accounted for using the equity method.

BC39 Respondents also suggested that the IFRS should provide more clarity in stating the requirements for the accounting for shares of assets in joint operations. Many respondents to ED 9 were not clear whether parties to a joint operation that had rights to the assets should recognise a 'right to use' or a 'right to a share' or whether they should instead directly recognise 'their share of the joint assets, classified according to the nature of the asset'. The concern raised by this uncertainty was the different accounting implications of these interpretations—ie accounting for rights or accounting for shares of assets. The Board concluded that a party to a joint operation should recognise its assets or its share of any assets in accordance with the IFRSs applicable to the particular assets.

BC40 An additional concern raised by some respondents to ED 9 was how the unit of account relating to the share of assets and liabilities to be accounted for by the parties to a joint operation should be delineated. The Board observed that ED 9 had not been intended to change this aspect of IAS 31, where the 'share' is determined in accordance with the contractual arrangement. The Board concluded that the contractual arrangement generally delineates the 'share' or 'part' not only of the assets or liabilities of the parties to joint operations, but also of their 'share' of any revenues and expenses arising from the joint operation.

Joint venture

BC41 In relation to the accounting for interests in joint ventures, the Board decided that entities should recognise their interests using the equity method in accordance with IAS 28 *Investments in Associates and Joint Ventures*, unless the entity is exempted from applying the equity method as stated in that standard. In reaching that conclusion, the Board considered the views of some respondents to ED 9 who pointed out that joint control and significant influence are different. Proponents of this view argue that it is not appropriate to account for an associate and a joint venture in the same way using the equity method. Although the Board acknowledged that significant influence and joint control are different, the Board concluded that, except for specific circumstances that are addressed in IAS 28 (as amended in 2011), the equity method is the most appropriate method to account for joint ventures because it is a method that accounts for an entity's interest in the net assets of an investee. Reconsideration of the equity method was outside the scope of the joint ventures project.

BC42 Other respondents expressed concerns about the elimination of proportionate consolidation. Those respondents believe that proportionate consolidation more faithfully represents the economic substance of the arrangements, and better meets the information needs of users of financial statements. The Board acknowledged these concerns, but observed that the approach in the IFRS is consistent with its view of what constitutes the economic substance of an entity's interests in joint arrangements, a view that it concedes may differ from that of those respondents. This seems inevitable given that, the evidence suggests that in accounting for interests in jointly controlled entities approximately half of the entities applying IFRSs use proportionate consolidation and half use the equity method. The variation in practice, which is facilitated by the option in IAS 31, is a prime motivation for developing IFRS 11 (see paragraphs BC7 and BC8). That variation will, inevitably, be a source of disagreement.

BC43 The Board believes that the accounting for joint arrangements should faithfully reflect the rights and obligations that the parties have in respect of the assets and liabilities relating to the arrangement. In that respect, the Board observes that the activities that are the subject of different joint arrangements might be operationally very similar, but that the contractual terms agreed by the parties to these joint arrangements might confer on the parties very different rights to the assets, and obligations for the liabilities, relating to such activities. Consequently, the Board believes that the economic substance of the arrangements does not depend exclusively on whether the activities undertaken through joint arrangements are closely related to the activities undertaken by the parties on their own, or on whether the parties are closely involved in the operations of the arrangements. Instead, the economic substance of the arrangements depends on the rights and obligations assumed by the parties when carrying out such activities. It is those rights and obligations that the accounting for joint arrangements should reflect.

BC44 The Board observes that the IFRS requires parties to account for assets and liabilities when the contractual arrangement specifies that they have rights to the assets and obligations for the liabilities. The Board believes that accounting for joint arrangements that is based on the principles of the IFRS will contribute not only to improving the faithful representation of an entity's interests in joint arrangements, but also to enhancing comparability. This is because arrangements in which the parties have rights to the assets and obligations for the liabilities will require the same accounting treatment. In the same way, arrangements in which the parties have rights to the net assets of the arrangement will also require the same accounting treatment.

BC45 The Board does not believe that the elimination of proportionate consolidation will cause a loss of information for users of financial statements. This is because the disclosure requirements in IFRS 12, when compared with IAS 31, will improve the quality of the information provided to users relating to an entity's interest in joint ventures. The disclosure requirements in IFRS 12 will provide users with information about individual joint ventures when those joint ventures are material to the reporting entity. In addition, the Board notes that the summarised financial information required in IFRS 12 results in a higher degree of detail than did IAS 31, which gives users a better basis for assessing the effect on the reporting entity of the activities carried out through joint ventures.

Transactions between an entity and a joint operation in which that entity is a joint operator and incorporation of SIC-13 into the IFRS

BC46 In its redeliberation of ED 9, the Board noted that the exposure draft was silent on the accounting for transactions between an entity and a joint operation in which that entity is a joint operator. The Board observed that the IFRS did not aim to change the accounting procedures that entities applied when accounting for such transactions in accordance with IAS 31, but it did acknowledge that the IFRS should state what those requirements were.

BC47 The Board also decided to include the requirements for the accounting for transactions entered into between a joint venturer and a joint venture, including the consensus of SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*, in IAS 28 (as amended in 2011).

Reporting interests in joint arrangements in the financial statements of parties that participate in, but do not have joint control of, a joint arrangement

BC48 The Board decided to clarify in the IFRS that an arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This was consistent with IAS 31, which defined an 'investor in a joint venture' as a party to a joint venture that does not have joint control of that joint venture. The Board noted, however, that relating the term 'investor' exclusively to parties with no joint control of the arrangement can be confusing because the parties with joint control of the arrangement are also investors in those arrangements. Accordingly, the Board modified the language in the IFRS to avoid that confusion. However, even though in its redeliberation of ED 9 the Board highlighted that the IFRS establishes recognition and measurement requirements for the parties with joint control of a joint arrangement, the Board decided to address the accounting requirements for parties that participate in, but do not have joint control of, a joint arrangement, to reduce divergence in practice.

BC49 In relation to parties that participate in, but do not have joint control of, a joint arrangement that is a joint operation, the Board focused its discussions on those parties for which the contractual arrangements specify that they have rights to the assets, and obligations for the liabilities, relating to the joint operation. The Board concluded that, even though those parties are not joint operators, they do have rights and obligations for the assets, liabilities, revenues and expenses relating to the joint operation, which they should recognise in accordance with the terms of the contractual arrangement.

BC50 The Board considered that the requirements in IAS 31 for parties that participate in, but do not have joint control of, joint ventures were appropriate and therefore decided to carry them forward to the IFRS. Consequently, such a party should account for its investment in accordance with IFRS 9 or, if that party has significant influence over the joint venture, in accordance with IAS 28 (as amended in 2011).

Joint operation held for sale

BC51 ED 9 was silent on how an entity should account for an interest in a joint operation that is classified as held for sale. The Board decided that a joint operator should account for an interest in a joint operation that is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. The Board also confirmed that the guidance in IFRS 5 for the classification of a disposal group as held for sale would apply to interests in joint operations held for sale.

Disclosure

BC52 As part of its redeliberation of ED 9 and ED 10 *Consolidated Financial Statements*, the Board identified an opportunity to integrate and make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities, and to present those requirements in a single IFRS.

BC53 The Board observed that IAS 27 (as revised in 2003), IAS 28 (as revised in 2003) and IAS 31 contained many similar disclosure requirements. ED 9 had already proposed amendments to the disclosure requirements for joint ventures and associates to align the disclosure requirements for those two types of investments more closely. The Board noted that the majority of respondents agreed with the proposals in ED 9 to align the disclosures for joint ventures with the disclosures in IAS 28 for associates.

BC54 As a result, the Board combined the disclosure requirements for interest with subsidiaries, joint arrangements, associates and unconsolidated structured entities within a single comprehensive standard, IFRS 12.

BC55 The Basis for Conclusions accompanying IFRS 12 summarises the Board's considerations in developing that IFRS, including its review of responses to the disclosure proposals in ED 9. Accordingly, IFRS 11 does not include disclosure requirements and this Basis for Conclusions does not incorporate the Board's considerations of responses to the proposed disclosure requirements in ED 9.

Effective date

BC56 The Board decided to align the effective date for the IFRS with the effective date for IFRS 10, IFRS 12, IAS 27 *Separate Financial Statements* and IAS 28 (as amended in 2011). When making this decision, the Board noted that the five IFRSs all deal with the assessment of, and related accounting and disclosure requirements about, a reporting entity's special relationships with other entities (ie when the reporting entity has control or joint control of, or significant influence over, another entity). As a result, the Board concluded that applying IFRS 11 without also applying the other four IFRSs could cause unwarranted confusion.

BC57 The Board usually sets an effective date of between twelve and eighteen months after issuing an IFRS. When deciding the effective date for those IFRSs, the Board considered the following factors:

(a) the time that many countries require for translation and for introducing the mandatory requirements into law.

(b) the consolidation project was related to the global financial crisis that started in 2007 and was accelerated by the Board in response to urgent requests from the leaders of the G20, the Financial Stability Board, users of financial statements, regulators and others to improve the accounting and disclosure of an entity's 'off balance sheet' activities.

(c) the comments received from respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 regarding implementation costs, effective date and transition requirements of the IFRSs to be issued in 2011. Most respondents did not identify the consolidation and joint arrangements IFRSs as having a high impact in terms of the time and resources that their implementation would require. In addition, only a few respondents commented that the effective dates of those IFRSs should be aligned with those of the other IFRSs to be issued in 2011.

BC58 With those factors in mind, the Board decided to require entities to apply the five IFRSs for annual periods beginning on or after 1 January 2013.

BC59 Most respondents to the Request for Views supported early application of the IFRSs to be issued in 2011. Respondents stressed that early application was especially important for first-time adopters in 2011 and 2012. The Board was persuaded by these arguments and decided to permit early application of IFRS 11 but only if an entity applies it in conjunction with the other IFRSs (ie IFRS 10, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011)) to avoid a lack of comparability among financial statements, and for the reasons noted in paragraph BC56 that triggered the Board's decision to set the same effective date for all five IFRSs. Even though an entity should apply the five IFRSs at the same time, the Board noted that an entity should not be prevented from providing any information required by IFRS 12 early if by doing so users gained a better understanding of the entity's relationships with other entities.

Transition

BC60 The exposure draft proposed retrospective application of the requirements. In its redeliberation of ED 9, the Board observed that entities affected by the changes introduced by the IFRS would have enough time to prepare to apply the new requirements retrospectively. The Board was informed of a few cases in which entities, on the basis of their analysis of the proposals in ED 9, had already changed their accounting for interests in joint arrangements retrospectively, taking advantage of the accounting option that IAS 31 offered to jointly controlled entities.

BC61 However, in its discussions, the Board considered the views of some respondents to ED 9 who had expressed their concern about applying the requirements retrospectively, because of undue cost and effort. In response to these concerns, the Board decided that in the case of changing from proportionate consolidation to the equity method, an entity should not adjust retrospectively any differences between the accounting methods of proportionate consolidation and equity method, but should instead aggregate the carrying amounts of the assets and liabilities, including any goodwill arising from acquisition, that the entity had previously proportionately consolidated into a single line investment as at the beginning of the earliest period presented.

BC62 The Board also decided that the opening balance of the investment should be tested for impairment in accordance with paragraphs 40–43 of IAS 28 (as amended in 2011), with any resulting impairment loss being adjusted against retained earnings at the beginning of the earliest period presented.

BC63 The Board also considered the case when an arrangement that was previously proportionately consolidated has a negative net asset position on transition. In such a case, an entity should assess whether it has legal or constructive obligations in relation to those negative net assets. The Board concluded that if the entity does not have legal or constructive obligations in relation to the negative net assets, it should not recognise the corresponding liability but it should adjust retained earnings at the beginning of the earliest period presented. The entity should also be required to disclose this fact along with its cumulative unrecognised share of losses of the joint venture as at the beginning of the earliest period presented and at the date at which the IFRS is first applied.

BC64 The Board also considered requiring disclosures to help users of financial statements to understand the consequences of the accounting change for those joint arrangements that would be changing from proportionate consolidation to the equity method. To address this need, the Board decided that an entity should disclose a breakdown of the assets and liabilities that have been aggregated into the single line investment as at the beginning of the earliest period presented.

BC65 The Board redeliberated the transition requirements for entities changing from the equity method to accounting for assets and liabilities in respect of their interest in a joint operation. The Board decided to require an entity to recognise each of the assets, including any goodwill arising from acquisition, and the liabilities relating to its interest in the joint operation at its carrying amount on the basis of the information used by the entity in applying the equity method, instead of requiring the entity to remeasure its share of each of those assets and liabilities at the date of transition. The Board did not believe that the costs of requiring entities to remeasure the assets and liabilities relating to the joint operation as a result of the accounting change would outweigh the benefits.

BC66 The Board observed that changing from the equity method to accounting for assets and liabilities in respect of an entity's interest in a joint operation could result in the net amount of the assets and liabilities recognised being either higher or lower than the investment (and any other items that formed part of the entity's net investment in the arrangement) derecognised. In the first case, the Board noted that assets and liabilities recognised could be higher than the investment derecognised when the entity had previously impaired the carrying amount of the investment. The Board observed that, in accordance with IAS 28 (as amended in 2011), such an impairment loss would not have been allocated to any asset, including goodwill, that formed part of the carrying amount of the investment and that as a result, the net amount of the underlying assets and liabilities could be higher than the carrying amount of the investment. To address this, the Board concluded that in such a case, an entity should first adjust the difference against any goodwill related to the investment, with any remaining difference adjusted against retained earnings at the beginning of the earliest period presented. In the second case, the Board noted that the net amount of the assets and liabilities recognised could be lower than the investment derecognised when, for example, an entity applied the same percentage interest to all the underlying assets and liabilities of its investee when determining the carrying amount of its investment using the equity method. However, for some of those underlying assets the entity could have a lower interest when accounting for it as a joint operation. The Board concluded that in such a case, an entity should adjust any difference between the net amount of the assets and liabilities recognised and the investment (and any other items that formed part of the entity's net investment in the arrangement) derecognised against retained earnings at the beginning of the earliest period presented.

BC67 The Board also redeliberated the transition requirements for entities accounting for an interest in a joint operation in its separate financial statements when the entity had previously accounted for this interest at cost or in accordance with IFRS 9. As stated in paragraph BC38, the Board observed that the parties' interests in a joint operation are recognised in their separate financial statements, resulting in no difference between what is recognised in the parties' separate financial statements and in the parties' consolidated financial statements. The Board decided that an entity should adjust any difference between the investment derecognised and the assets and liabilities recognised in respect of the entity's interest in a joint operation against retained earnings at the beginning of the earliest period presented.

BC68 The Board also considered requiring disclosures to help users of financial statements to understand the consequences of the accounting change from the equity method to accounting for assets and liabilities, and when accounting for an interest in a joint operation in the separate financial statements of an entity when the entity had previously accounted for this interest at cost or in accordance with IFRS 9. The Board decided that in both cases, an entity should provide a reconciliation between the investment derecognised and the breakdown of the assets and liabilities recognised, together with any remaining difference adjusted against retained earnings, at the beginning of the earliest period presented.

BC69 As stated in paragraph BC57, respondents to the Request for Views also commented on the transition requirements of the IFRSs to be issued in 2011. In relation to the transition requirements relating to the consolidation and joint arrangements IFRSs, the Board noted that the majority of the respondents to the Request for Views had agreed with the tentative decisions that the Board had previously made at the time of the consultation on the transition requirements for those IFRSs.

Summary of main changes from ED 9

BC70 The main changes from the exposure draft ED 9 are:

(a) IFRS 11 applies to all entities that have an interest in a joint arrangement. The scope exception in the exposure draft for venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, has been removed and has been recharacterised as an exemption from the requirement to measure investments in joint ventures in accordance with the equity method.

(b) IFRS 11 replaces the term 'shared decisions' introduced by ED 9 with the term 'joint control'. As in IAS 31, 'joint control' is one of the features that, along with the existence of a contractual arrangement, defines 'joint arrangements'.

(c) IFRS 11 classifies joint arrangements into two types—'joint operations' and 'joint ventures'. Each type of joint arrangement is aligned with a specific accounting requirement. ED 9 had classified joint arrangements into three types—'joint operations', 'joint assets' and 'joint ventures'.

(d) IFRS 11 provides application requirements to assist entities in the classification of their joint arrangements. The IFRS requires an entity to determine the type of joint arrangement in which it is involved by considering its rights and obligations. In particular, the IFRS requires an entity to give consideration to the structure and legal form of the arrangement, to the terms agreed by the parties in the contractual arrangement and, when relevant, it should also consider other facts and circumstances.

(e) IFRS 11 clarifies that not all the parties to a joint arrangement need to have joint control for the arrangement to be a joint arrangement. As a result, some of the parties to a joint arrangement might participate in the joint arrangement, but might not have joint control of it.

(f) The consensus of SIC-13 has been incorporated into IAS 28 (as amended in 2011), and SIC-13 is accordingly withdrawn. ED 9 had proposed to incorporate the consensus of SIC-13 into the standard on joint arrangements.

(g) The disclosure requirements have been placed in IFRS 12. ED 9 had proposed to incorporate the disclosure requirements for joint arrangements into the standard on joint arrangements.

(h) IFRS 11 does not require an entity to adjust the differences between the proportionate consolidation method and the equity method retrospectively when an entity changes from proportionate consolidation to the equity method when accounting for its joint ventures. Instead, it requires an entity to recognise its investment in a joint venture as at the beginning of the earliest period presented, by measuring it as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. ED 9 had proposed retrospective application of the requirements.

Cost-benefit considerations

BC71 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. To attain this objective, the Board seeks to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs to implement a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC72 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considered the following:

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

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

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

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

(e) the costs of transition for users, preparers and others.

BC73 The Board concluded that the IFRS benefits preparers and users of financial statements. This is because the accounting for joint arrangements in the IFRS follows a principle-based approach. This approach has allowed the Board to remove the accounting option in IAS 31 so that each type of joint arrangement (ie 'joint operations' and 'joint ventures') is accounted for on a consistent basis. This contributes to enhancing the verifiability, comparability and understandability of these arrangements in entities' financial statements.

BC74 In the IFRS, the accounting for joint arrangements depends on the rights and obligations arising from the arrangement (not exclusively on whether the parties have chosen a particular structure or legal form to carry out their arrangements, or on the consistent application of an accounting policy—proportionate consolidation or equity method). Thus, the IFRS promotes greater comparability by applying the same approach to different joint arrangements.

BC75 The Board believes that basing the accounting on the principles in the IFRS results in enhanced verifiability, comparability and understandability, to the benefit of both preparers and users. First, verifiability and understandability are enhanced because the accounting reflects more faithfully the economic phenomena that it purports to represent (ie an entity's rights and obligations arising from its arrangements), which allows them to be better understood. Second, requiring the same accounting for each type of arrangement will enable entities to account for joint arrangements consistently: arrangements that confer on the parties rights to the assets and obligations for the liabilities are joint operations and arrangements that confer on the parties rights to the net assets are joint ventures. Consistency in the accounting for joint arrangements will help to achieve comparability among financial statements, which will enable users to identify and understand similarities in, and differences between, different arrangements.

BC76 The Board noted that the costs that preparers will have to bear when applying the IFRS to their arrangements are concentrated in the assessment of the type of joint arrangement rather than in the accounting for the arrangements. This is because entities accounting for joint arrangements in accordance with IAS 31 were not required to classify their arrangements on the basis of their rights and obligations arising from the arrangement, but instead on whether the arrangement was structured in an entity. The IFRS will require entities to assess the type of joint arrangement in which they are involved when those arrangements have been structured through a separate vehicle. Even though the classification of the joint arrangements represents an additional assessment that was not required in IAS 31, the application requirements in the IFRS that should assist preparers in the classification of their arrangements are not unduly complex. The Board does not think that the additional assessment that the IFRS will require for the classification of arrangements will result in an undue cost to preparers.

BC77 The Board noted that the IFRS, by comparison with the exposure draft, simplifies the proposals by aligning the types of joint arrangement with the accounting methods. The Board concluded that once an entity has determined the classification of the arrangement, the accounting for the arrangement will follow accounting procedures that have not been modified by the IFRS (ie entities will either account for assets and liabilities or they will account for an investment using the equity method). However, the Board acknowledged that the requirement for joint operations to be accounted for in the same way in the entity's consolidated financial statements as in the entity's separate financial statements might lead to additional costs to entities in jurisdictions in which separate financial statements are required to be reported in accordance with IFRSs. This is because those requirements might cause entities to perform additional manual procedures such as reconciliations between the statutory accounts and the tax returns, and might require an entity to provide additional explanations of the impact of the changes to, for example, its creditors. Except for these costs and any other costs required on transition, the costs of accounting for joint arrangements once the entities have determined their classification will remain unchanged as a result of the IFRS.

BC78 The Board concluded that enhanced verifiability, comparability and understandability result in a more faithful representation of joint arrangements in the financial statements of the entities that are involved in such arrangements, and that those benefits outweigh the costs that preparers might incur when implementing the IFRS.

Appendix
Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 11 and the related amendments to other IFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

BCA1 In paragraph BC30(f), the heading above paragraph BC58A and in paragraphs BC58A and BC58K the term 'jointly controlled entities' is footnoted as follows:

* 'Jointly controlled entities' were defined in IAS 31 *Interests in Joint Ventures*. IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31 and changed the terminology.

Paragraph BC30 is amended as follows:

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

(a) …

(l) borrowing costs (paragraph BC63E); ~~and~~

(m) severe hyperinflation (paragraphs BC63F–BC63J)~~.~~ ; and

(n) joint arrangements (paragraphs BC63K and BC63L).

A heading and paragraphs BC63K and BC63L are added.

Joint arrangements

BC63K During its redeliberation of the exposure draft ED 9 *Joint Arrangements* the Board decided not to require entities changing from proportionate consolidation to the equity method to adjust any differences between the two accounting methods retrospectively. Instead an entity should determine the opening balance of the investment relating to its interest in a joint venture as the aggregate of the carrying amounts of the assets and liabilities that the entity had been previously proportionately consolidated, including any goodwill arising from acquisition as at the beginning of the earliest period presented. The Board decided to treat first-time adopters in the same way as entities that already apply IFRSs with the following exception.

BC63L A first-time adopter is required to test for impairment the opening investment in accordance with IAS 36 at the earliest period presented, regardless of whether there is any indication that the investment may be impaired. The Board noted that this is a more stringent requirement for the application of IFRS 11 *Joint Arrangements* by first-time adopters, but is aligned with the requirement for first-time adopters to apply IAS 36 in testing goodwill for impairment at the date of transition to IFRSs regardless of whether there is any indication that the goodwill may be impaired.

IFRS 3 *Business Combinations*

BCA2 In paragraph BC60, 'IAS 31 *Interests in Joint Ventures*' is footnoted as follows:

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

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

BCA3 After paragraph BC72, a heading and paragraph BC72A are added.

Changes to a plan of sale (amendment 2011)

BC72A During its redeliberation of the exposure draft ED 9 *Joint Arrangements* the Board decided that if a disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary, a joint operation, a joint venture, an associate, or a portion of an interest in a joint venture or associate, an entity should amend its financial statements for the periods since the classification as held for sale was made.

IFRS 9 *Financial Instruments* (issued October 2010)

BCA4 In paragraph BCZ4.109 'IAS 28 *Investments in Associates*' is footnoted as follows:

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

IAS 21 *The Effects of Changes in Foreign Exchange Rates*

BCA5 In paragraph BC33, 'a jointly controlled entity' is footnoted as follows:

* 'Jointly controlled entities' were defined in IAS 31 *Interests in Joint Ventures*. IFRS 11 *Joint Arrangements,* issued in May 2011, replaced IAS 31 and changed the terminology.

After paragraph BC35, a heading and paragraphs BC36–BC40 are added.

Disposal or partial disposal of a foreign operation (amendment 2011)

BC36 During its redeliberation of the exposure draft ED 9 *Joint Arrangements*, the Board reconsidered whether its decision in the second phase of the business combinations project to characterise loss of joint control or loss of significant influence as a significant economic event (ie in the same way that loss of control is characterised as a significant economic event) was appropriate. If it were, the Board thought that the entity should be required to recalibrate the accounting as required by IFRS 10 *Consolidated Financial Statements*. However, the Board concluded that, although significant, the events are fundamentally different. In the case of loss of control, the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost the composition of the group is unaffected.

BC37 The Board also noted that retaining the characterisation of significant economic event in the case of loss of joint control or significant influence when the retained interest is a financial asset is unnecessary. IFRS 9 already requires that in such cases the retained interest (ie a financial asset) must be measured at fair value.

BC38 In the case of loss of joint control when significant influence is maintained, the Board acknowledged that the investor-investee relationship changes and, consequently, so does the nature of the investment. However, in this instance, both investments (ie the joint venture and the associate) continue to be measured using the equity method. Considering that there is neither a change in the group boundaries nor a change in the measurement requirements, the Board concluded that losing joint control and retaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.

BC39 Consequently, the Board removed all descriptions that characterise loss of joint control or significant influence as a significant economic event as introduced in the second phase of the Board's project on business combinations.

BC40 The Board also decided to align the conclusions reached on the loss of joint control when significant influence is maintained with the requirements in IAS 21 so that the change from joint control to significant influence is treated as a 'partial' disposal rather than deemed to be an 'entire' disposal. As a consequence, the Board concluded that when an entity loses joint control of a joint arrangement that includes a foreign operation but retains significant influence, an entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income relating to a foreign operation in that joint arrangement.

IAS 24 *Related Party Disclosures*

BCA6 In paragraph BC15 of IAS 24, 'IAS 28 *Investments in Associates*' is footnoted as follows:

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

and 'IAS 31 *Interests in Joint Ventures*' is footnoted as follows:

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

IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

BCA7 In paragraph BC2 'IAS 28 *Investments in Associates*' is footnoted as follows:

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

and 'IAS 31 *Interests in Joint Ventures*' is footnoted as follows:

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

In paragraphs BC9 and BC23 'IAS 31' is footnoted as follows:

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

In paragraph BC26 'proportional consolidation' is footnoted as follows:

* IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31. IFRS 11 does not permit an entity to use 'proportional consolidation' for accounting for interests in joint ventures.

IFRIC 9 *Reassessment of Embedded Derivatives*

BCA8 In paragraph BC5A 'venturer' is footnoted as follows:

* IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31. IFRS 11 uses the term 'joint venturers' to designate parties that have joint control of a joint venture.

HKFRS 11 IE
Issued June 2011

Illustrative Examples
Hong Kong Financial Reporting Standard 11

Joint Arrangements

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

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Illustrative examples
IFRS 11 *Joint Arrangements*

These examples accompany, but are not part of, IFRS 11. They illustrate aspects of IFRS 11 but are not intended to provide interpretative guidance.

IE1 These examples portray hypothetical situations illustrating the judgements that might be used when applying IFRS 11 in different situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IFRS 11.

Example 1 – Construction services

IE2 A and B (the parties) are two companies whose businesses are the provision of many types of public and private construction services. They set up a contractual arrangement to work together for the purpose of fulfilling a contract with a government for the design and construction of a road between two cities. The contractual arrangement determines the participation shares of A and B and establishes joint control of the arrangement, the subject matter of which is the delivery of the road.

IE3 The parties set up a separate vehicle (entity Z) through which to conduct the arrangement. Entity Z, on behalf of A and B, enters into the contract with the government. In addition, the assets and liabilities relating to the arrangement are held in entity Z. The main feature of entity Z's legal form is that the parties, not entity Z, have rights to the assets, and obligations for the liabilities, of the entity.

IE4 The contractual arrangement between A and B additionally establishes that:

(a) the rights to all the assets needed to undertake the activities of the arrangement are shared by the parties on the basis of their participation shares in the arrangement;

(b) the parties have several and joint responsibility for all operating and financial obligations relating to the activities of the arrangement on the basis of their participation shares in the arrangement; and

(c) the profit or loss resulting from the activities of the arrangement is shared by A and B on the basis of their participation shares in the arrangement.

IE5 For the purposes of co-ordinating and overseeing the activities, A and B appoint an operator, who will be an employee of one of the parties. After a specified time, the role of the operator will rotate to an employee of the other party. A and B agree that the activities will be executed by the operator's employees on a 'no gain or loss' basis.

IE6 In accordance with the terms specified in the contract with the government, entity Z invoices the construction services to the government on behalf of the parties.

Analysis

IE7 The joint arrangement is carried out through a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (ie the assets and liabilities held in entity Z are the parties' assets and liabilities). This is reinforced by the terms agreed by the parties in their contractual arrangement, which state that A and B have rights to the assets, and obligations for the liabilities, relating to the arrangement that is conducted through entity Z. The joint arrangement is a joint operation.

IE8 A and B each recognise in their financial statements their share of the assets (eg property, plant and equipment, accounts receivable) and their share of any liabilities resulting from the arrangement (eg accounts payable to third parties) on the basis of their agreed participation share. Each also recognises its share of the revenue and expenses resulting from the construction services provided to the government through entity Z.

Example 2 – Shopping centre operated jointly

IE9 Two real estate companies (the parties) set up a separate vehicle (entity X) for the purpose of acquiring and operating a shopping centre. The contractual arrangement between the parties establishes joint control of the activities that are conducted in entity X. The main feature of entity X's legal form is that the entity, not the parties, has rights to the assets, and obligations for the liabilities, relating to the arrangement. These activities include the rental of the retail units, managing the car park, maintaining the centre and its equipment, such as lifts, and building the reputation and customer base for the centre as a whole.

IE10 The terms of the contractual arrangement are such that:

(a) entity X owns the shopping centre. The contractual arrangement does not specify that the parties have rights to the shopping centre.

(b) the parties are not liable in respect of the debts, liabilities or obligations of entity X. If entity X is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of each party to any third party will be limited to the unpaid amount of that party's capital contribution.

(c) the parties have the right to sell or pledge their interests in entity X.

(d) each party receives a share of the income from operating the shopping centre (which is the rental income net of the operating costs) in accordance with its interest in entity X.

Analysis

IE11 The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the contractual arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the contractual arrangement establish that the parties have rights to the net assets of entity X.

IE12 On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets relating to the arrangement, and that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.

IE13 The parties recognise their rights to the net assets of entity X as investments and account for them using the equity method.

Example 3 – Joint manufacturing and distribution of a product

IE14 Companies A and B (the parties) have set up a strategic and operating agreement (the framework agreement) in which they have agreed the terms according to which they will conduct the manufacturing and distribution of a product (product P) in different markets.

IE15 The parties have agreed to conduct manufacturing and distribution activities by establishing joint arrangements, as described below:

(a) Manufacturing activity: the parties have agreed to undertake the manufacturing activity through a joint arrangement (the manufacturing arrangement). The manufacturing arrangement is structured in a separate vehicle (entity M) whose legal form causes it to be considered in its own right (ie the assets and liabilities held in entity M are the assets and liabilities of entity M and not the assets and liabilities of the parties). In accordance with the framework agreement, the parties have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement in accordance with their ownership interests in entity M. The parties subsequently sell product P to another arrangement, jointly controlled by the two parties themselves, that has been established exclusively for the distribution of product P as described below. Neither the framework agreement nor the contractual arrangement between A and B dealing with the manufacturing activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity.

(b) Distribution activity: the parties have agreed to undertake the distribution activity through a joint arrangement (the distribution arrangement). The parties have structured the distribution arrangement in a separate vehicle (entity D) whose legal form causes it to be considered in its own right (ie the assets and liabilities held in entity D are the assets and liabilities of entity D and not the assets and liabilities of the parties). In accordance with the framework agreement, the distribution arrangement orders its requirements for product P from the parties according to the needs of the different markets where the distribution arrangement sells the product. Neither the framework agreement nor the contractual arrangement between A and B dealing with the distribution activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the distribution activity.

IE16 In addition, the framework agreement establishes:

(a) that the manufacturing arrangement will produce product P to meet the requirements for product P that the distribution arrangement places on the parties;

(b) the commercial terms relating to the sale of product P by the manufacturing arrangement to the parties. The manufacturing arrangement will sell product P to the parties at a price agreed by A and B that covers all production costs incurred. Subsequently, the parties sell the product to the distribution arrangement at a price agreed by A and B.

(c) that any cash shortages that the manufacturing arrangement may incur will be financed by the parties in accordance with their ownership interests in entity M.

Analysis

IE17 The framework agreement sets up the terms under which parties A and B conduct the manufacturing and distribution of product P. These activities are undertaken through joint arrangements whose purpose is either the manufacturing or the distribution of product P.

IE18 The parties carry out the manufacturing arrangement through entity M whose legal form confers separation between the parties and the entity. In addition, neither the framework agreement nor the contractual arrangement dealing with the manufacturing activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, when considering the following facts and circumstances the parties have concluded that the manufacturing arrangement is a joint operation:

(a) The parties have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement. Consequently, A and B have rights to substantially all the economic benefits of the assets of the manufacturing arrangement.

(b) The manufacturing arrangement manufactures product P to meet the quantity and quality needs of the parties so that they can fulfil the demand for product P of the distribution arrangement. The exclusive dependence of the manufacturing arrangement upon the parties for the generation of cash flows and the parties' commitments to provide funds when the manufacturing arrangement incurs any cash shortages indicate that the parties have an obligation for the liabilities of the manufacturing arrangement, because those liabilities will be settled through the parties' purchases of product P or by the parties' direct provision of funds.

IE19 The parties carry out the distribution activities through entity D, whose legal form confers separation between the parties and the entity. In addition, neither the framework agreement nor the contractual arrangement dealing with the distribution activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the distribution activity.

IE20 There are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets relating to the distribution arrangement or that the parties have an obligation for the liabilities relating to that arrangement. The distribution arrangement is a joint venture.

IE21 A and B each recognise in their financial statements their share of the assets (eg property, plant and equipment, cash) and their share of any liabilities resulting from the manufacturing arrangement (eg accounts payable to third parties) on the basis of their ownership interest in entity M. Each party also recognises its share of the expenses resulting from the manufacture of product P incurred by the manufacturing arrangement and its share of the revenues relating to the sales of product P to the distribution arrangement.

IE22 The parties recognise their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Variation

IE23 Assume that the parties agree that the manufacturing arrangement described above is responsible not only for manufacturing product P, but also for its distribution to third-party customers.

IE24 The parties also agree to set up a distribution arrangement like the one described above to distribute product P exclusively to assist in widening the distribution of product P in additional specific markets.

IE25 The manufacturing arrangement also sells product P directly to the distribution arrangement. No fixed proportion of the production of the manufacturing arrangement is committed to be purchased by, or to be reserved to, the distribution arrangement.

Analysis

IE26 The variation has affected neither the legal form of the separate vehicle in which the manufacturing activity is conducted nor the contractual terms relating to the parties' rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, it causes the manufacturing arrangement to be a self-financed arrangement because it is able to undertake trade on its own behalf, distributing product P to third-party customers and, consequently, assuming demand, inventory and credit risks. Even though the manufacturing arrangement might also sell product P to the distribution arrangement, in this scenario the manufacturing arrangement is not dependent on the parties to be able to carry out its activities on a continuous basis. In this case, the manufacturing arrangement is a joint venture.

IE27 The variation has no effect on the classification of the distribution arrangement as a joint venture.

IE28 The parties recognise their rights to the net assets of the manufacturing arrangement and their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Example 4 – Bank operated jointly

IE29 Banks A and B (the parties) agreed to combine their corporate, investment banking, asset management and services activities by establishing a separate vehicle (bank C). Both parties expect the arrangement to benefit them in different ways. Bank A believes that the arrangement could enable it to achieve its strategic plans to increase its size, offering an opportunity to exploit its full potential for organic growth through an enlarged offering of products and services. Bank B expects the arrangement to reinforce its offering in financial savings and market products.

IE30 The main feature of bank C's legal form is that it causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). Banks A and B each have a 40 per cent ownership interest in bank C, with the remaining 20 per cent being listed and widely held. The shareholders' agreement between bank A and bank B establishes joint control of the activities of bank C.

IE31 In addition, bank A and bank B entered into an irrevocable agreement under which, even in the event of a dispute, both banks agree to provide the necessary funds in equal amount and, if required, jointly and severally, to ensure that bank C complies with the applicable legislation and banking regulations, and honours any commitments made to the banking authorities. This commitment represents the assumption by each party of 50 per cent of any funds needed to ensure that bank C complies with legislation and banking regulations.

Analysis

IE32 The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the contractual arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, of bank C, but it establishes that the parties have rights to the net assets of bank C. The commitment by the parties to provide support if bank C is not able to comply with the applicable legislation and banking regulations is not by itself a determinant that the parties have an obligation for the liabilities of bank C. There are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets of bank C and that the parties have an obligation for the liabilities of bank C. The joint arrangement is a joint venture.

IE33 Both banks A and B recognise their rights to the net assets of bank C as investments and account for them using the equity method.

Example 5 – Oil and gas exploration, development and production activities

IE34 Companies A and B (the parties) set up a separate vehicle (entity H) and a Joint Operating Agreement (JOA) to undertake oil and gas exploration, development and production activities in country O. The main feature of entity H's legal form is that it causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties).

IE35 Country O has granted entity H permits for the oil and gas exploration, development and production activities to be undertaken in a specific assigned block of land (fields).

IE36 The shareholders' agreement and JOA agreed by the parties establish their rights and obligations relating to those activities. The main terms of those agreements are summarised below.

Shareholders' agreement

IE37 The board of entity H consists of a director from each party. Each party has a 50 per cent shareholding in entity H. The unanimous consent of the directors is required for any resolution to be passed.

Joint Operating Agreement (JOA)

IE38 The JOA establishes an Operating Committee. This Committee consists of one representative from each party. Each party has a 50 per cent participating interest in the Operating Committee.

IE39 The Operating Committee approves the budgets and work programmes relating to the activities, which also require the unanimous consent of the representatives of each party. One of the parties is appointed as operator and is responsible for managing and conducting the approved work programmes.

IE40 The JOA specifies that the rights and obligations arising from the exploration, development and production activities shall be shared among the parties in proportion to each party's shareholding in entity H. In particular, the JOA establishes that the parties share:

(a) the rights and the obligations arising from the exploration and development permits granted to entity H (eg the permits, rehabilitation liabilities, any royalties and taxes payable);

(b) the production obtained; and

(c) all costs associated with all work programmes.

IE41 The costs incurred in relation to all the work programmes are covered by cash calls on the parties. If either party fails to satisfy its monetary obligations, the other is required to contribute to entity H the amount in default. The amount in default is regarded as a debt owed by the defaulting party to the other party.

Analysis

IE42 The parties carry out the joint arrangement through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The parties have been able to reverse the initial assessment of their rights and obligations arising from the legal form of the separate vehicle in which the arrangement is conducted. They have done this by agreeing terms in the JOA that entitle them to rights to the assets (eg exploration and development permits, production, and any other assets arising from the activities) and obligations for the liabilities (eg all costs and obligations arising from the work programmes) that are held in entity H. The joint arrangement is a joint operation.

IE43 Both company A and company B recognise in their financial statements their own share of the assets and of any liabilities resulting from the arrangement on the basis of their agreed participating interest. On that basis, each party also recognises its share of the revenue (from the sale of their share of the production) and its share of the expenses.

Example 6 – Liquefied natural gas arrangement

IE44 Company A owns an undeveloped gas field that contains substantial gas resources. Company A determines that the gas field will be economically viable only if the gas is sold to customers in overseas markets. To do so, a liquefied natural gas (LNG) facility must be built to liquefy the gas so that it can be transported by ship to the overseas markets.

IE45 Company A enters into a joint arrangement with company B in order to develop and operate the gas field and the LNG facility. Under that arrangement, companies A and B (the parties) agree to contribute the gas field and cash, respectively, to a new separate vehicle, entity C. In exchange for those contributions, the parties each take a 50 per cent ownership interest in entity C. The main feature of entity C's legal form is that it causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties).

IE46 The contractual arrangement between the parties specifies that:

(a) companies A and B must each appoint two members to the board of entity C. The board of directors must unanimously agree the strategy and investments made by entity C.

(b) day-to-day management of the gas field and LNG facility, including development and construction activities, will be undertaken by the staff of company B in accordance with the directions jointly agreed by the parties. Entity C will reimburse B for the costs it incurs in managing the gas field and LNG facility.

(c) entity C is liable for taxes and royalties on the production and sale of LNG as well as for other liabilities incurred in the ordinary course of business, such as accounts payable, site restoration and decommissioning liabilities.

(d) companies A and B have equal shares in the profit from the activities carried out in the arrangement and, as such, are entitled to equal shares of any dividends distributed by entity C.

IE47 The contractual arrangement does not specify that either party has rights to the assets, or obligations for the liabilities, of entity C.

IE48 The board of entity C decides to enter into a financing arrangement with a syndicate of lenders to help fund the development of the gas field and construction of the LNG facility. The estimated total cost of the development and construction is CU1,000 million.*

IE49 The lending syndicate provides entity C with a CU700 million loan. The arrangement specifies that the syndicate has recourse to companies A and B only if entity C defaults on the loan arrangement during the development of the field and construction of the LNG facility. The lending syndicate agrees that it will not have recourse to companies A and B once the LNG facility is in production because it has assessed that the cash inflows that entity C should generate from LNG sales will be sufficient to meet the loan repayments. Although at this time the lenders have no recourse to companies A and B, the syndicate maintains protection against default by entity C by taking a lien on the LNG facility.

* In this example monetary amounts are denominated in 'currency units (CU)'.

Analysis

IE50 The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the contractual arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, of entity C, but they establish that the parties have rights to the net assets of entity C. The recourse nature of the financing arrangement during the development of the gas field and construction of the LNG facility (ie companies A and B providing separate guarantees during this phase) does not, by itself, impose on the parties an obligation for the liabilities of entity C (ie the loan is a liability of entity C). Companies A and B have separate liabilities, which are their guarantees to repay that loan if entity C defaults during the development and construction phase.

IE51 There are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets of entity C and that the parties have an obligation for the liabilities of entity C. The joint arrangement is a joint venture.

IE52 The parties recognise their rights to the net assets of entity C as investments and account for them using the equity method.

HKFRS 12
Issued June 2011

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 12

Disclosure of Interests in Other Entities

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

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Hong Kong Financial Reporting Standard 12 *Disclosure of Interests in Other Entities* (HKFRS 12) is set out in paragraphs 1–31 and Appendices A–D. 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. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 12 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 HKFRS 12 *Disclosure of Interests in Other Entities* applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.

IN2 The HKFRS is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Reasons for issuing the HKFRS

IN3 Users of financial statements have consistently requested improvements to the disclosure of a reporting entity's interests in other entities to help identify the profit or loss and cash flows available to the reporting entity and determine the value of a current or future investment in the reporting entity.

IN4 They highlighted the need for better information about the subsidiaries that are consolidated, as well as an entity's interests in joint arrangements and associates that are not consolidated but with which the entity has a special relationship.

IN5 The global financial crisis that started in 2007 also highlighted a lack of transparency about the risks to which a reporting entity was exposed from its involvement with structured entities, including those that it had sponsored.

IN6 In response to input received from users and others, including the G20 leaders and the Financial Stability Board, the International Accounting Standards Board decided to address in IFRS 12 (that is, the international equivalent of HKFRS 12) the need for improved disclosure of a reporting entity's interests in other entities when the reporting entity has a special relationship with those other entities.

IN7 The IASB identified an opportunity to integrate and make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and present those requirements in a single standard. The IASB observed that the disclosure requirements of HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 28 *Investments in Associates* and HKAS 31 *Interests in Joint Ventures* overlapped in many areas. In addition, many commented that the disclosure requirements for interests in unconsolidated structured entities should not be located in a consolidation standard. Therefore, the IASB concluded that a combined disclosure standard for interests in other entities would make it easier to understand and apply the disclosure requirements for subsidiaries, joint ventures, associates and unconsolidated structured entities.

Main features of the HKFRS

IN8 The HKFRS requires an entity to disclose information that enables users of financial statements to evaluate:

(a) the nature of, and risks associated with, its interests in other entities; and

(b) the effects of those interests on its financial position, financial performance and cash flows.

General requirements

IN9 The HKFRS establishes disclosure objectives according to which an entity discloses information that enables users of its financial statements

(a) to understand:

(i) the significant judgements and assumptions (and changes to those judgements and assumptions) made in determining the nature of its interest in another entity or arrangement (ie control, joint control or significant influence), and in determining the type of joint arrangement in which it has an interest; and

(ii) the interest that non-controlling interests have in the group's activities and cash flows; and

(b) to evaluate:

(i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;

(ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;

(iii) the nature and extent of its interests in unconsolidated structured entities, and the nature of, and changes in, the risks associated with those interests;

(iv) the nature, extent and financial effects of its interests in joint arrangements and associates, and the nature of the risks associated with those interests;

(v) the consequences of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control; and

(vi) the consequences of losing control of a subsidiary during the reporting period.

IN10 The HKFRS specifies minimum disclosures that an entity must provide. If the minimum disclosures required by the HKFRS are not sufficient to meet the disclosure objective, an entity discloses whatever additional information is necessary to meet that objective.

IN11 The HKFRS requires an entity to consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in the HKFRS. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

Hong Kong Financial Reporting Standard 12
Disclosure of Interests in Other Entities

Objective

1 **The objective of this HKFRS is to require an entity to disclose information that enables users of its financial statements to evaluate:**

(a) the nature of, and risks associated with, its *interests in other entities*; and

(b) the effects of those interests on its financial position, financial performance and cash flows.

Meeting the objective

2 To meet the objective in paragraph 1, an entity shall disclose:

(a) the significant judgements and assumptions it has made in determining the nature of its interest in another entity or arrangement, and in determining the type of joint arrangement in which it has an interest (paragraphs 7–9); and

(b) information about its interests in:

(i) subsidiaries (paragraphs 10–19);

(ii) joint arrangements and associates (paragraphs 20–23); and

(iii) *structured entities* that are not controlled by the entity (unconsolidated structured entities) (paragraphs 24–31).

3 If the disclosures required by this HKFRS, together with disclosures required by other HKFRSs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.

4 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in this HKFRS. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraphs B2–B6).

Scope

5 This HKFRS shall be applied by an entity that has an interest in any of the following:

(a) subsidiaries

(b) joint arrangements (ie joint operations or joint ventures)

(c) associates

(d) unconsolidated structured entities.

6 This HKFRS does not apply to:

(a) post-employment benefit plans or other long-term employee benefit plans to which HKAS 19 *Employee Benefits* applies.

(b) an entity's separate financial statements to which HKAS 27 *Separate Financial Statements* applies. However, if an entity has interests in unconsolidated structured entities and prepares separate financial statements as its only financial statements, it shall apply the requirements in paragraphs 24–31 when preparing those separate financial statements.

(c) an interest held by an entity that participates in, but does not have joint control of, a joint arrangement unless that interest results in significant influence over the arrangement or is an interest in a structured entity.

(d) an interest in another entity that is accounted for in accordance with HKFRS 9 *Financial Instruments*. However, an entity shall apply this HKFRS:

(i) when that interest is an interest in an associate or a joint venture that, in accordance with HKAS 28 *Investments in Associates and Joint Ventures*, is measured at fair value through profit or loss; or

(ii) when that interest is an interest in an unconsolidated structured entity.

Significant judgements and assumptions

7 An entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

(a) that it has control of another entity, ie an investee as described in paragraphs 5 and 6 of HKFRS 10 *Consolidated Financial Statements*;

(b) that it has joint control of an arrangement or significant influence over another entity; and

(c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

8 The significant judgements and assumptions disclosed in accordance with paragraph 7 include those made by the entity when changes in facts and circumstances are such that the conclusion about whether it has control, joint control or significant influence changes during the reporting period.

9 To comply with paragraph 7, an entity shall disclose, for example, significant judgements and assumptions made in determining that:

(a) it does not control another entity even though it holds more than half of the voting rights of the other entity.

(b) it controls another entity even though it holds less than half of the voting rights of the other entity.

(c) it is an agent or a principal (see paragraphs 58–72 of HKFRS 10).

(d) it does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity.

(e) it has significant influence even though it holds less than 20 per cent of the voting rights of another entity.

Interests in subsidiaries

10 **An entity shall disclose information that enables users of its consolidated financial statements**

(a) to understand:

(i) the composition of the group; and

(ii) the interest that non-controlling interests have in the group's activities and cash flows (paragraph 12); and

(b) to evaluate:

(i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group (paragraph 13);

(ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities (paragraphs 14–17);

(iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control (paragraph 18); and

(iv) the consequences of losing control of a subsidiary during the reporting period (paragraph 19).

11 When the financial statements of a subsidiary used in the preparation of consolidated financial statements are as of a date or for a period that is different from that of the consolidated financial statements (see paragraphs B92 and B93 of HKFRS 10), an entity shall disclose:

(a) the date of the end of the reporting period of the financial statements of that subsidiary; and

(b) the reason for using a different date or period.

The interest that non-controlling interests have in the group's activities and cash flows

12 An entity shall disclose for each of its subsidiaries that have non-controlling interests that are material to the reporting entity:

(a) the name of the subsidiary.

(b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary.

(c) the proportion of ownership interests held by non-controlling interests.

(d) the proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held.

(e) the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.

(f) accumulated non-controlling interests of the subsidiary at the end of the reporting period.

(g) summarised financial information about the subsidiary (see paragraph B10).

The nature and extent of significant restrictions

13 An entity shall disclose:

(a) significant restrictions (eg statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the group, such as:

(i) those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group.

(ii) guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group.

(b) the nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a subsidiary).

(c) the carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

Nature of the risks associated with an entity's interests in consolidated structured entities

14 An entity shall disclose the terms of any contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated structured entity, including events or circumstances that could expose the reporting entity to a loss (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support).

15 If during the reporting period a parent or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to a consolidated structured entity (eg purchasing assets of or instruments issued by the structured entity), the entity shall disclose:

(a) the type and amount of support provided, including situations in which the parent or its subsidiaries assisted the structured entity in obtaining financial support; and

(b) the reasons for providing the support.

16 If during the reporting period a parent or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to a previously unconsolidated structured entity and that provision of support resulted in the entity controlling the structured entity, the entity shall disclose an explanation of the relevant factors in reaching that decision.

17 An entity shall disclose any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

Consequences of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control

18 An entity shall present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control.

Consequences of losing control of a subsidiary during the reporting period

19 An entity shall disclose the gain or loss, if any, calculated in accordance with paragraph 25 of HKFRS 10, and:

(a) the portion of that gain or loss attributable to measuring any investment retained in the former subsidiary at its fair value at the date when control is lost; and

(b) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

Interests in joint arrangements and associates

20 An entity shall disclose information that enables users of its financial statements to evaluate:

(a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates (paragraphs 21 and 22); and

(b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates (paragraph 23).

Nature, extent and financial effects of an entity's interests in joint arrangements and associates

21 An entity shall disclose:

(a) for each joint arrangement and associate that is material to the reporting entity:

(i) the name of the joint arrangement or associate.

(ii) the nature of the entity's relationship with the joint arrangement or associate (by, for example, describing the nature of the activities of the joint arrangement or associate and whether they are strategic to the entity's activities).

(iii) the principal place of business (and country of incorporation, if applicable and different from the principal place of business) of the joint arrangement or associate.

(iv) the proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable).

(b) for each joint venture and associate that is material to the reporting entity:

(i) whether the investment in the joint venture or associate is measured using the equity method or at fair value.

(ii) summarised financial information about the joint venture or associate as specified in paragraphs B12 and B13.

(iii) if the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment.

(c) financial information as specified in paragraph B16 about the entity's investments in joint ventures and associates that are not individually material:

(i) in aggregate for all individually immaterial joint ventures and, separately,

(ii) in aggregate for all individually immaterial associates.

22 An entity shall also disclose:

(a) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual arrangements between investors with joint control of or significant influence over a joint venture or an associate) on the ability of joint ventures or associates to transfer funds to the entity in the form of cash dividends, or to repay loans or advances made by the entity.

(b) when the financial statements of a joint venture or associate used in applying the equity method are as of a date or for a period that is different from that of the entity:

(i) the date of the end of the reporting period of the financial statements of that joint venture or associate; and

(ii) the reason for using a different date or period.

(c) the unrecognised share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognising its share of losses of the joint venture or associate when applying the equity method.

Risks associated with an entity's interests in joint ventures and associates

23 An entity shall disclose:

(a) commitments that it has relating to its joint ventures separately from the amount of other commitments as specified in paragraphs B18–B20.

(b) in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, unless the probability of loss is remote, contingent liabilities incurred relating to its interests in joint ventures or associates (including its share of contingent liabilities incurred jointly with other investors with joint control of, or significant influence over, the joint ventures or associates), separately from the amount of other contingent liabilities.

Interests in unconsolidated structured entities

24 An entity shall disclose information that enables users of its financial statements:

(a) to understand the nature and extent of its interests in unconsolidated structured entities (paragraphs 26–28); and

(b) to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities (paragraphs 29–31).

25 The information required by paragraph 24(b) includes information about an entity's exposure to risk from involvement that it had with unconsolidated structured entities in previous periods (eg sponsoring the structured entity), even if the entity no longer has any contractual involvement with the structured entity at the reporting date.

Nature of interests

26 An entity shall disclose qualitative and quantitative information about its interests in unconsolidated structured entities, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed.

27 If an entity has sponsored an unconsolidated structured entity for which it does not provide information required by paragraph 29 (eg because it does not have an interest in the entity at the reporting date), the entity shall disclose:

(a) how it has determined which structured entities it has sponsored;

(b) *income from those structured entities* during the reporting period, including a description of the types of income presented; and

(c) the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.

28 An entity shall present the information in paragraph 27(b) and (c) in tabular format, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (see paragraphs B2–B6).

Nature of risks

29 An entity shall disclose in tabular format, unless another format is more appropriate, a summary of:

(a) the carrying amounts of the assets and liabilities recognised in its financial statements relating to its interests in unconsolidated structured entities.

(b) the line items in the statement of financial position in which those assets and liabilities are recognised.

(c) the amount that best represents the entity's maximum exposure to loss from its interests in unconsolidated structured entities, including how the maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interests in unconsolidated structured entities it shall disclose that fact and the reasons.

(d) a comparison of the carrying amounts of the assets and liabilities of the entity that relate to its interests in unconsolidated structured entities and the entity's maximum exposure to loss from those entities.

30 If during the reporting period an entity has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated structured entity in which it previously had or currently has an interest (for example, purchasing assets of or instruments issued by the structured entity), the entity shall disclose:

(a) the type and amount of support provided, including situations in which the entity assisted the structured entity in obtaining financial support; and

(b) the reasons for providing the support.

31 An entity shall disclose any current intentions to provide financial or other support to an unconsolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

income from a structured entity	For the purpose of this HKFRS, income from a **structured entity** includes, but is not limited to, recurring and non-recurring fees, interest, dividends, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.
interest in another entity	For the purpose of this HKFRS, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship. Paragraphs B7–B9 provide further information about interests in other entities. Paragraphs B55–B57 of HKFRS 10 explain variability of returns.
structured entity	An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. Paragraphs B22–B24 provide further information about structured entities.

The following terms are defined in HKAS 27 (as amended in 2011), HKAS 28 (as amended in 2011), HKFRS 10 and HKFRS 11 *Joint Arrangements* and are used in this HKFRS with the meanings specified in those HKFRSs:

- associate
- consolidated financial statements
- control of an entity
- equity method
- group
- joint arrangement
- joint control
- joint operation

- joint venture
- non-controlling interest
- parent
- protective rights
- relevant activities
- separate financial statements
- separate vehicle
- significant influence
- subsidiary.

Appendix B
Application guidance

This appendix is an integral part of the HKFRS. It describes the application of paragraphs 1–31 and has the same authority as the other parts of the HKFRS.

B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying HKFRS 12.

Aggregation (paragraph 4)

B2 An entity shall decide, in the light of its circumstances, how much detail it provides to satisfy the information needs of users, how much emphasis it places on different aspects of the requirements and how it aggregates the information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

B3 An entity may aggregate the disclosures required by this HKFRS for interests in similar entities if aggregation is consistent with the disclosure objective and the requirement in paragraph B4, and does not obscure the information provided. An entity shall disclose how it has aggregated its interests in similar entities.

B4 An entity shall present information separately for interests in:

(a) subsidiaries;

(b) joint ventures;

(c) joint operations;

(d) associates; and

(e) unconsolidated structured entities.

B5 In determining whether to aggregate information, an entity shall consider quantitative and qualitative information about the different risk and return characteristics of each entity it is considering for aggregation and the significance of each such entity to the reporting entity. The entity shall present the disclosures in a manner that clearly explains to users of financial statements the nature and extent of its interests in those other entities.

B6 Examples of aggregation levels within the classes of entities set out in paragraph B4 that might be appropriate are:

(a) nature of activities (eg a research and development entity, a revolving credit card securitisation entity).

(b) industry classification.

(c) geography (eg country or region).

Interests in other entities

B7 An interest in another entity refers to contractual and non-contractual involvement that exposes the reporting entity to variability of returns from the performance of the other entity. Consideration of the purpose and design of the other entity may help the reporting entity when assessing whether it has an interest in that entity and, therefore, whether it is required to provide the disclosures in this HKFRS. That assessment shall include consideration of the risks that the other entity was designed to create and the risks the other entity was designed to pass on to the reporting entity and other parties.

B8 A reporting entity is typically exposed to variability of returns from the performance of another entity by holding instruments (such as equity or debt instruments issued by the other entity) or having another involvement that absorbs variability. For example, assume a structured entity holds a loan portfolio. The structured entity obtains a credit default swap from another entity (the reporting entity) to protect itself from the default of interest and principal payments on the loans. The reporting entity has involvement that exposes it to variability of returns from the performance of the structured entity because the credit default swap absorbs variability of returns of the structured entity.

B9 Some instruments are designed to transfer risk from a reporting entity to another entity. Such instruments create variability of returns for the other entity but do not typically expose the reporting entity to variability of returns from the performance of the other entity. For example, assume a structured entity is established to provide investment opportunities for investors who wish to have exposure to entity Z's credit risk (entity Z is unrelated to any party involved in the arrangement). The structured entity obtains funding by issuing to those investors notes that are linked to entity Z's credit risk (credit-linked notes) and uses the proceeds to invest in a portfolio of risk-free financial assets. The structured entity obtains exposure to entity Z's credit risk by entering into a credit default swap (CDS) with a swap counterparty. The CDS passes entity Z's credit risk to the structured entity in return for a fee paid by the swap counterparty. The investors in the structured entity receive a higher return that reflects both the structured entity's return from its asset portfolio and the CDS fee. The swap counterparty does not have involvement with the structured entity that exposes it to variability of returns from the performance of the structured entity because the CDS transfers variability to the structured entity, rather than absorbing variability of returns of the structured entity.

Summarised financial information for subsidiaries, joint ventures and associates (paragraphs 12 and 21)

B10 For each subsidiary that has non-controlling interests that are material to the reporting entity, an entity shall disclose:

(a) dividends paid to non-controlling interests.

(b) summarised financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that non-controlling interests have in the group's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income.

B11 The summarised financial information required by paragraph B10(b) shall be the amounts before inter-company eliminations.

B12 For each joint venture and associate that is material to the reporting entity, an entity shall disclose:

(a) dividends received from the joint venture or associate.

(b) summarised financial information for the joint venture or associate (see paragraphs B14 and B15) including, but not necessarily limited to:

(i) current assets.

(ii) non-current assets.

(iii) current liabilities.

(iv) non-current liabilities.

(v) revenue.

(vi) profit or loss from continuing operations.

(vii) post-tax profit or loss from discontinued operations.

(viii) other comprehensive income.

(ix) total comprehensive income.

B13 In addition to the summarised financial information required by paragraph B12, an entity shall disclose for each joint venture that is material to the reporting entity the amount of:

(a) cash and cash equivalents included in paragraph B12(b)(i).

(b) current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iii).

(c) non-current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iv).

(d) depreciation and amortisation.

(e) interest income.

(f) interest expense.

(g) income tax expense or income.

B14 The summarised financial information presented in accordance with paragraphs B12 and B13 shall be the amounts included in the HKFRS financial statements of the joint venture or associate (and not the entity's share of those amounts). If the entity accounts for its interest in the joint venture or associate using the equity method:

(a) the amounts included in the HKFRS financial statements of the joint venture or associate shall be adjusted to reflect adjustments made by the entity when using the equity method, such as fair value adjustments made at the time of acquisition and adjustments for differences in accounting policies.

(b) the entity shall provide a reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint venture or associate.

B15 An entity may present the summarised financial information required by paragraphs B12 and B13 on the basis of the joint venture's or associate's financial statements if:

(a) the entity measures its interest in the joint venture or associate at fair value in accordance with HKAS 28 (as amended in 2011); and

(b) the joint venture or associate does not prepare HKFRS financial statements and preparation on that basis would be impracticable or cause undue cost.

In that case, the entity shall disclose the basis on which the summarised financial information has been prepared.

B16 An entity shall disclose, in aggregate, the carrying amount of its interests in all individually immaterial joint ventures or associates that are accounted for using the equity method. An entity shall also disclose separately the aggregate amount of its share of those joint ventures' or associates':

(a) profit or loss from continuing operations.

(b) post-tax profit or loss from discontinued operations.

(c) other comprehensive income.

(d) total comprehensive income.

An entity provides the disclosures separately for joint ventures and associates.

B17 When an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) is classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the entity is not required to disclose summarised financial information for that subsidiary, joint venture or associate in accordance with paragraphs B10–B16.

Commitments for joint ventures (paragraph 23(a))

B18 An entity shall disclose total commitments it has made but not recognised at the reporting date (including its share of commitments made jointly with other investors with joint control of a joint venture) relating to its interests in joint ventures. Commitments are those that may give rise to a future outflow of cash or other resources.

B19 Unrecognised commitments that may give rise to a future outflow of cash or other resources include:

(a) unrecognised commitments to contribute funding or resources as a result of, for example:

(i) the constitution or acquisition agreements of a joint venture (that, for example, require an entity to contribute funds over a specific period).

(ii) capital-intensive projects undertaken by a joint venture.

(iii) unconditional purchase obligations, comprising procurement of equipment, inventory or services that an entity is committed to purchasing from, or on behalf of, a joint venture.

(iv) unrecognised commitments to provide loans or other financial support to a joint venture.

(v) unrecognised commitments to contribute resources to a joint venture, such as assets or services.

(vi) other non-cancellable unrecognised commitments relating to a joint venture.

(b) unrecognised commitments to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture if a particular event occurs or does not occur in the future.

B20 The requirements and examples in paragraphs B18 and B19 illustrate some of the types of disclosure required by paragraph 18 of HKAS 24 *Related Party Disclosures*.

Interests in unconsolidated structured entities (paragraphs 24–31)

Structured entities

B21 A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

B22 A structured entity often has some or all of the following features or attributes:

(a) restricted activities.

(b) a narrow and well-defined objective, such as to effect a tax-efficient lease, carry out research and development activities, provide a source of capital or funding to an entity or provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors.

(c) insufficient equity to permit the structured entity to finance its activities without subordinated financial support.

(d) financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks (tranches).

B23 Examples of entities that are regarded as structured entities include, but are not limited to:

(a) securitisation vehicles.

(b) asset-backed financings.

(c) some investment funds.

B24 An entity that is controlled by voting rights is not a structured entity simply because, for example, it receives funding from third parties following a restructuring.

Nature of risks from interests in unconsolidated structured entities (paragraphs 29–31)

B25 In addition to the information required by paragraphs 29–31, an entity shall disclose additional information that is necessary to meet the disclosure objective in paragraph 24(b).

B26 Examples of additional information that, depending on the circumstances, might be relevant to an assessment of the risks to which an entity is exposed when it has an interest in an unconsolidated structured entity are:

(a) the terms of an arrangement that could require the entity to provide financial support to an unconsolidated structured entity (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support), including:

  (i) a description of events or circumstances that could expose the reporting entity to a loss.

  (ii) whether there are any terms that would limit the obligation.

  (iii) whether there are any other parties that provide financial support and, if so, how the reporting entity's obligation ranks with those of other parties.

(b) losses incurred by the entity during the reporting period relating to its interests in unconsolidated structured entities.

(c) the types of income the entity received during the reporting period from its interests in unconsolidated structured entities.

(d) whether the entity is required to absorb losses of an unconsolidated structured entity before other parties, the maximum limit of such losses for the entity, and (if relevant) the ranking and amounts of potential losses borne by parties whose interests rank lower than the entity's interest in the unconsolidated structured entity.

(e) information about any liquidity arrangements, guarantees or other commitments with third parties that may affect the fair value or risk of the entity's interests in unconsolidated structured entities.

(f) any difficulties an unconsolidated structured entity has experienced in financing its activities during the reporting period.

(g) in relation to the funding of an unconsolidated structured entity, the forms of funding (eg commercial paper or medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of an unconsolidated structured entity if the structured entity has longer-term assets funded by shorter-term funding.

Appendix C
Effective date and transition

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

Effective date and transition

C1 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

C2 An entity is encouraged to provide information required by this HKFRS earlier than annual periods beginning on or after 1 January 2013. Providing some of the disclosures required by this HKFRS does not compel the entity to comply with all the requirements of this HKFRS or to apply HKFRS 10, HKFRS 11, HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) early.

References to HKFRS 9

C3 If an entity applies this HKFRS but does not yet apply HKFRS 9, any reference to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*.

Appendix D
Amendments to other HKFRSs

This appendix sets out amendments to other HKFRSs that are a consequence of issuing HKFRS 12. An entity shall apply the amendments for annual periods beginning on or after 1 January 2013. If an entity applies HKFRS 12 for an earlier period, it shall apply the amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

HKAS 1 *Presentation of Financial Statements*

D1 Paragraphs 119 and 124 are amended and paragraph 139H is added as follows.

119 … An example is disclosure of whether ~~a venturer recognises its interest in a jointly controlled entity using proportionate consolidation or the equity method (see HKAS 31 *Interests in Joint Ventures*)~~ <u>an entity applies the fair value or cost model to its investment property (see HKAS 40 *Investment Property*)</u>. Some HKFRSs specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. …

124 Some of the disclosures made in accordance with paragraph 122 are required by other HKFRSs. For example, ~~HKAS 27 requires an entity to disclose the reasons why the entity's ownership interest does not constitute control, in respect of an investee that is not a subsidiary even though more than half of its voting or potential voting power is owned directly or indirectly through subsidiaries~~ <u>HKFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose the judgements it has made in determining whether it controls another entity</u>. HKAS 40 ~~*Investment Property*~~ requires…

139H HKFRSs 10 and 12, issued in June 2011, amended paragraphs 4, 119, 123 and 124. An entity shall apply those amendments when it applies HKFRSs 10 and 12.

HKAS 24 *Related Party Disclosures*

D2 Paragraph 15 is amended and paragraph 28A is added as follows.

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

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

Appendix E
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 12.

The International Financial Reporting Standard comparable with HKFRS 12 is IFRS 12 *Disclosure of Interests in Other Entities*.

There are no major textual differences between HKFRS 12 and IFRS 12.

HKFRS 12 BC
Issued June 2011

Basis for Conclusions on
Hong Kong Financial Reporting Standard 12

Disclosure of Interests in Other Entities

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

Basis for Conclusions on HKFRS 12 *Disclosure of Interests in Other Entities*

HKFRS 12 is based on IFRS 12 *Disclosure of Interests in Other Entities*. In approving HKFRS 12, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 12. Accordingly, there are no significant differences between HKFRS 12 and IFRS 12. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 12 referred to below generally correspond with those in HKFRS 12.

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Basis for Conclusions on IFRS 12 *Disclosure of Interests in Other Entities*

This Basis for Conclusions accompanies, but is not part of, IFRS 12.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing IFRS 12 *Disclosure of Interests in Other Entities*. Individual Board members gave greater weight to some factors than to others.

BC2 Users of financial statements have consistently requested improvements to the disclosure of a reporting entity's interests in other entities to help identify the profit or loss and cash flows available to the reporting entity and determine the value of a current or future investment in the reporting entity.

BC3 They highlighted the need for better information about the subsidiaries that are consolidated, as well as an entity's interests in joint arrangements and associates that are not consolidated but with which the entity has a special relationship.

BC4 The global financial crisis that started in 2007 also highlighted a lack of transparency about the risks to which a reporting entity was exposed from its involvement with structured entities, including those that it had sponsored.

BC5 IFRS 12 addresses the disclosure of a reporting entity's interests in other entities when the reporting entity has a special relationship with those other entities, ie it controls another entity, has joint control of or significant influence over another entity or has an interest in an unconsolidated structured entity.

BC6 In developing IFRS 12, the Board considered the responses to its exposure drafts, ED 9 *Joint Arrangements* and ED 10 *Consolidated Financial Statements*. ED 9 proposed amendments to the disclosure requirements for joint ventures and associates to align more closely the disclosure requirements for those two types of investments. ED 10 proposed amendments to the disclosure requirements for subsidiaries and new disclosure requirements for unconsolidated structured entities.

BC7 During its consideration of the responses to ED 9 and ED 10, the Board identified an opportunity to integrate and make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and present those requirements in a single IFRS. The Board observed that the disclosure requirements of IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* overlapped in many areas. In addition, many respondents to ED 10 commented that the disclosure requirements for interests in unconsolidated structured entities should not be located in a consolidation standard. Therefore, the Board concluded that a combined disclosure standard for interests in other entities would make it easier to understand and apply the disclosure requirements for subsidiaries, joint ventures, associates and unconsolidated structured entities.

BC8 The Board decided to extend the scope of IFRS 12 to interests in joint operations. A joint operation is a joint arrangement that is not necessarily structured through an entity that is separate from the parties to the joint arrangement. Therefore, an interest in a joint operation does not necessarily represent an interest in another entity. The Board decided to include disclosure requirements for joint operations in IFRS 12 because it believes that the benefits of having all disclosure requirements for joint arrangements in one place outweighs the disadvantages of including disclosure requirements about interests in joint operations in a standard that otherwise deals with an entity's interests in other entities.

The structure of IFRS 12 and the Board's deliberations

BC9 IFRS 12 replaces the disclosure requirements in IAS 27, IAS 28 and IAS 31, except for the disclosure requirements that apply only when preparing separate financial statements, which are included in IAS 27 *Separate Financial Statements*.

BC10 Unless otherwise stated, any references in this Basis for Conclusions to:

(a) IAS 27 are to IAS 27 *Consolidated and Separate Financial Statements*.

(b) IAS 28 are to IAS 28 *Investments in Associates*.

(c) IAS 31 are to IAS 31 *Interests in Joint Ventures*.

BC11 In developing IFRS 12, the Board did not reconsider all the requirements that are included in the IFRS. The requirements in paragraphs 11, 18 and 19 relate to disclosures about some of the accounting requirements in IFRS 10 *Consolidated Financial Statements*, which were carried forward from IAS 27 to IFRS 10 without being reconsidered by the Board. Consequently, the Board did not reconsider the requirements in those paragraphs. In addition, the requirements in paragraph 22 relate to disclosures about the application of the equity method and restrictions on the ability of joint ventures and associates to transfer funds to the reporting entity. The Board did not reconsider the equity method as part of its joint ventures project. Consequently, and with the exception of its decision to align the requirements for joint ventures and associates as stated in paragraph BC6, the requirements in paragraph 22 were carried forward from IAS 28 without being reconsidered by the Board. Accordingly, when the Board approved IFRS 12 for issue, it brought forward from IAS 27 and IAS 28 without reconsideration the requirements now in paragraphs 11, 18, 19 and 22 of IFRS 12.

BC12 When revised in 2003, IAS 27 was accompanied by a Basis for Conclusions summarising the considerations of the Board, as constituted at the time, in reaching some of its conclusions in that standard. The Basis for Conclusions was subsequently updated to reflect amendments to the standard. For convenience, the Board has incorporated into its Basis for Conclusions on IFRS 12 material from the Basis for Conclusions on IAS 27 that discusses the requirements in paragraphs 18 and 19 that the Board has not reconsidered. That material is contained in paragraphs BC37–BC41. In those paragraphs cross-references to the IFRS have been updated accordingly and minor necessary editorial changes have been made.

BC13 As part of its consolidation project, the Board is examining how an investment entity accounts for its interests in subsidiaries, joint ventures and associates and what, if any, additional disclosures might be made about those interests. The Board expects to publish later in 2011 an exposure draft on investment entities.

Significant judgements and assumptions

BC14 The assessment of whether an entity controls another entity sometimes requires judgement. Paragraph 122 of IAS 1 *Presentation of Financial Statements* requires an entity to disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

BC15 IAS 27 and IAS 28 supplemented the general disclosure requirement in IAS 1 with more specific requirements relating to an entity's decision about whether it controls or has significant influence over another entity. Those standards required disclosure of information when an entity's control or significant influence assessment was different from the presumptions of control or significant influence in IAS 27 and IAS 28 (ie more than 50 per cent voting power for control and 20 per cent or more voting power for significant influence).

BC16 The Board decided to replace the specific disclosure requirements in IAS 27 and IAS 28 with a principle that an entity must disclose all significant judgements and assumptions made in determining the nature of its interest in another entity or arrangement, and in determining the type of joint arrangement in which it has an interest. Moreover, the requirement for such disclosures should not be limited to particular scenarios. Instead, disclosure should be required for all situations in which an entity applies significant judgement in assessing the nature of its interest in another entity. The disclosure requirements formerly in IAS 27 and IAS 28 in this respect were included as examples of situations for which significant judgement might need to be applied.

BC17 ED 10 proposed that, for two particular scenarios for which the control assessment was different, an entity should provide information, in aggregate, that would help users evaluate the accounting consequences of the decision to consolidate another entity.

BC18 Most users supported the proposal. However, other respondents to ED 10 expressed the view that disclosing such quantitative information about the accounting consequences was a step too far. They were concerned that such a disclosure would encourage 'second-guessing' by users of financial statements and, therefore, replace the judgement made by management with that made by users of financial statements.

BC19 The Board acknowledged those concerns, but observed that consideration of different scenarios is common practice when analysing financial statements and does not necessarily mean that the judgement of management is replaced with that of other parties. However, the Board noted that IFRS 3 *Business Combinations* requires an entity to disclose information that enables users of financial statements to evaluate the nature and financial effect of a business combination—ie when an entity obtains control of another business or businesses. Furthermore, if an entity's assessment that it does not control another entity requires significant judgement, the entity will often conclude that it has either joint control of or significant influence over that other entity. The Board observed that IFRS 12 will require an entity to disclose quantitative information about its interests in joint ventures and associates, and information about its exposure to risk from its interests in unconsolidated structured entities. Therefore, the Board concluded that there was no need for a separate requirement to disclose quantitative information to help assess the accounting consequences of an entity's decision to consolidate (or not to consolidate) another entity.

Interests in subsidiaries

BC20 IFRS 12 requires an entity to disclose information that enables users of financial statements

(a) to understand:

(i) the composition of the group; and

(ii) the interest that non-controlling interests have in the group's activities and cash flows; and

(b) to evaluate:

(i) the nature and the effect of significant restrictions on its ability to access and use assets of the group, and settle liabilities of the group;

(ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;

(iii) the consequences of changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

(iv) the consequences of losing control of a subsidiary during the reporting period.

Composition of the group and non-controlling interests

BC21 Consolidated financial statements present the financial position, comprehensive income and cash flows of the group as a single entity. They ignore the legal boundaries of the parent and its subsidiaries. However, those legal boundaries could affect the parent's access to and use of assets and other resources of its subsidiaries and, therefore, affect the cash flows that can be distributed to the shareholders of the parent.

BC22 When the Board was developing IFRS 12, users informed the Board that, as part of their analysis of financial statements, they need to identify profit or loss and cash flows attributable to the shareholders of the parent and those attributable to non-controlling interests.

BC23 IAS 1 provides some of the information necessary to perform the valuations by requiring an entity to present:

(a) in the statement of financial position, the non-controlling interest within equity;

(b) in the statement of comprehensive income, profit or loss and total comprehensive income for the period attributable to the non-controlling interest; and

(c) in the statement of changes in equity, a reconciliation between the non-controlling interest at the beginning of the period and the end of the period.

BC24 Although confirming that the presentation requirements in IAS 1 provide important information, users of financial statements requested additional information to enable them to make better estimates of future profit or loss and cash flows attributable to the shareholders of the parent. The Board was advised that, in particular, an analyst requires information about the non-controlling interests' share of the profit or loss, cash flows and net assets of subsidiaries with material non-controlling interests.

BC25 Those users of financial statements also requested specific disclosure requirements in this respect, rather than simply a disclosure objective as was proposed in ED 10. In their view, only specific disclosure requirements would enhance their ability to estimate the profit or loss and cash flows attributable to the ordinary shareholders of the parent and provide comparable information for different entities. Users specifically requested additional financial information about consolidated entities.

BC26 The Board was convinced by those comments and decided to require an entity to provide the following information for each subsidiary that has non-controlling interests that are material to the group:

(a) *the name of the subsidiary,* because naming subsidiaries that have non-controlling interests that are material to the group helps users search for other information that might be useful for their analysis of the subsidiary.

(b) *the principal place of business (and country of incorporation, if different),* because this helps users understand the political, economic and currency risks associated with those subsidiaries and the laws with which those subsidiaries must comply.

(c) *the proportion of ownership interests held by non-controlling interests; if different, the proportion of voting rights held by non-controlling interests; profit or loss allocated to non-controlling interests and accumulated non-controlling interests at the end of the reporting period,* because this information helps users understand the profit or loss and cash flows attributable to the shareholders of the parent and the amount attributable to non-controlling interests.

(d) *summarised financial information for the subsidiary,* because this information helps users understand the profit or loss and cash flows attributable to the shareholders of the parent and the amount attributable to non-controlling interests.

BC27 The Board believes that the disclosures required will help users when estimating future profit or loss and cash flows by identifying, for example:

(a) the assets and liabilities that are held by subsidiaries;

(b) risk exposures of particular group entities (eg by identifying which subsidiaries hold debt); and

(c) those subsidiaries that generate significant cash flows.

BC28 In reaching its decision, the Board noted that users have consistently requested additional financial information about consolidated entities for many years. Although users have requested financial information about all subsidiaries that are material to the group, the Board decided to require financial information only for those subsidiaries with material non-controlling interests. A requirement to disclose information about subsidiaries with immaterial or no non-controlling interests might prove to be onerous to prepare without any significant benefit for users, who are expected to benefit most from having financial information about subsidiaries with material non-controlling interests.

Summarised financial information about subsidiaries with material non-controlling interests helps users predict how future cash flows will be distributed among those with claims against the entity including the non-controlling interests.

BC29 In addition, the Board does not think that this requirement to provide information about subsidiaries with material non-controlling interests will be particularly onerous to prepare. This is because an entity should have the information available in preparing its consolidated financial statements.

Restrictions on assets and liabilities

BC30 IAS 27 required disclosures about the nature and extent of significant restrictions on the ability of subsidiaries to transfer funds to the parent. Users of financial statements noted that, in addition to legal requirements, the existence of non-controlling interests in a subsidiary might restrict the subsidiary's ability to transfer funds to the parent or any of its other subsidiaries. However, the disclosure requirement in IAS 27 regarding significant restrictions did not refer explicitly to non-controlling interests.

BC31 Accordingly, the Board decided to amend the requirement in IAS 27 to disclose restrictions in order to clarify that the information disclosed should include the nature and extent to which protective rights of non-controlling interests can restrict the entity's ability to access and use the assets and settle the liabilities of a subsidiary.

BC32 In response to concerns raised by respondents to ED 10 about the extent of the disclosure requirement, the Board decided to limit the disclosures to information about the nature and effect of *significant* restrictions on an entity's ability to access and use assets or settle liabilities of the group. In reaching that decision, the Board confirmed that the proposal was never intended to require an entity to disclose, for example, a list of all the protective rights held by non-controlling interests that are embedded in law and regulation.

BC33 The Board also confirmed that the restrictions required to be disclosed by IFRS 12 are those that exist because of the legal boundaries within the group, such as restrictions on transferring cash between group entities. The requirement in IFRS 12 is not intended to replicate those in other IFRSs relating to restrictions, such as those in IAS 16 *Property, Plant and Equipment* or IAS 40 *Investment Property*.

Risks associated with an entity's interests in consolidated structured entities

BC34 An entity can be exposed to risks from both consolidated and unconsolidated structured entities. The Board concluded that it would help users of financial statements in understanding an entity's exposure to risks if the entity disclosed the terms of contractual arrangements that could require it to provide financial support to a consolidated structured entity, including events or circumstances that could expose the entity to a loss.

BC35 The Board concluded for the same reason that an entity should disclose its risk exposure from non-contractual obligations to provide support to both consolidated and unconsolidated structured entities (see paragraphs BC102–BC106).

BC36 The Board noted that US generally accepted accounting principles (GAAP) require similar disclosures, which have been well received by users of financial statements in the US.

Changes in ownership interests in subsidiaries

BC37 In its deliberations in the second phase of the business combinations project, the US Financial Accounting Standards Board (FASB) decided to require entities with one or more partially-owned subsidiaries to disclose in the notes to the consolidated financial statements a schedule showing the effects on the controlling interest's equity of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control.

BC38 In the exposure draft proposing amendments to IAS 27 published in 2005, the Board did not propose to require this disclosure. The Board noted that IFRSs require this information to be provided in the statement of changes in equity or in the notes to the financial statements. This is because IAS 1 requires an entity to present, within the statement of changes in equity, a reconciliation between the carrying amount of each component of equity at the beginning and end of the period, disclosing separately each change.

BC39 Many respondents to the 2005 exposure draft requested more prominent disclosure of the effects of transactions with non-controlling interests on the equity of the owners of the parent. Therefore, the Board decided to converge with the FASB's disclosure requirement and to require that if a parent has equity transactions with non-controlling interests, it should disclose in a separate schedule the effects of those transactions on the equity of the owners of the parent.

BC40 The Board understands that some users will be interested in information pertaining only to the owners of the parent. The Board expected that the presentation and disclosure requirements of IAS 27, as amended in 2008, would meet their information needs. (These presentation and disclosure requirements are now included in IFRS 12.)

Loss of control

BC41 The Board decided that the amount of any gain or loss arising on the loss of control of a subsidiary, including the portion of the gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost, and the line item in the statement of comprehensive income in which the gains or losses are recognised should be disclosed. This disclosure requirement, which took effect from 1 July 2009, provides information about the effect of the loss of control of a subsidiary on the financial position at the end of, and performance for, the reporting period.

Interests in joint arrangements and associates

BC42 The Board proposed in ED 9 to align the disclosure requirements for joint ventures and associates by proposing consequential amendments to IAS 28 and by extending the application of some disclosure requirements in IAS 28 to investments in joint ventures.

BC43 During its consideration of responses to ED 9, the Board questioned whether it was possible to achieve further alignment between the disclosure requirements for joint ventures and associates, to the extent that the nature of the particular type of interest does not justify different disclosure requirements. Although joint control is different from significant influence, the Board concluded that the disclosure requirements for joint arrangements and associates could share a common disclosure objective—to disclose information that enables users of financial statements to evaluate the nature, extent and financial effects of an entity's interests in joint arrangements and associates, and the nature of the risks associated with those interests.

Nature, extent and financial effects of interests in joint arrangements and associates

BC44 In response to requests from users of financial statements, the Board proposed in ED 9 that an entity should disclose a list and description of investments in significant joint ventures and associates. Respondents to ED 9 generally welcomed the proposal. The Board decided to carry the proposals forward into IFRS 12 with some modifications as described in paragraphs BC45 and BC46.

BC45 The Board decided to require the information for joint arrangements and associates that are material to the reporting entity rather than for significant joint arrangements and associates. The *Conceptual Framework for Financial Reporting* defines materiality whereas the term 'significant' is undefined and can be interpreted differently. Consequently, the Board decided to replace 'significant' with 'material', which is also used in IFRS 3. The Board noted that materiality should be assessed in relation to an entity's consolidated financial statements or other primary financial statements in which joint ventures and associates are accounted for using the equity method.

BC46 In addition, the Board noted that ED 9 unintentionally changed the application of the requirement in IAS 31 to provide a description of interests in all joint arrangements to interests in joint ventures only. As such, the Board modified the requirement so that it would continue to be required for all joint arrangements that are material to an entity.

Summarised financial information

BC47 IAS 28 and IAS 31 required disclosure of aggregated summarised financial information relating to joint ventures and associates. In response to requests from users of financial statements, ED 9 proposed to expand the requirements so that summarised financial information would be provided for each joint venture that is material to an entity.

BC48 Respondents to ED 9 generally agreed that summarised financial information should be provided. Some had concerns about confidentiality when providing summarised financial information on an individual basis for some joint ventures that were established to implement a single project. Others, including users of financial statements, were concerned that the elimination of proportionate consolidation would result in a loss of information. They therefore requested more detailed disclosures so that the effect of joint ventures on the activities of an entity could be better understood. They stated that there was a need for a detailed breakdown of current assets and current and non-current liabilities (in particular, cash and financial liabilities excluding trade payables and provisions), which would help users understand the net debt position of joint ventures. These users also highlighted the need for a more detailed breakdown of amounts presented in the statement of comprehensive income (such as depreciation and amortisation) that would help when valuing an entity's investment in a joint venture.

BC49 ED 9 proposed that an entity should present summarised financial information for each material joint venture on the basis of its proportionate interest in the joint venture. The Board reconsidered the proposal, noting that it would be confusing to present the entity's share of the assets, liabilities and revenue of a joint venture or associate when the entity has neither rights to, nor obligations for, the assets and liabilities of the joint venture or associate. Rather, the entity has an interest in the net assets of the joint ventures or associates. Consequently, the Board concluded that an entity should present the summarised financial information for each material joint venture on a '100 per cent' basis, and reconcile that to the carrying amount of its investment in the joint venture or associate.

BC50 The Board observed that the requirement to present the amounts on a '100 per cent' basis would be appropriate only when the information is disclosed for individual joint ventures and associates. This is because presenting the financial information on a '100 per cent' basis when aggregating that information for all joint ventures or associates would not result in useful information when the entity holds different percentage ownership interests in its joint ventures or associates. In addition, some users and respondents to ED 9 recommended that the disclosures for associates should be aligned with those for joint ventures because investments in associates can be material and are often strategic to an investor with significant influence. Accordingly, the Board decided that summarised financial information should also be provided for each material associate.

BC51 Nonetheless, the minimum line item disclosures required for each material associate would be less than those required for each material joint venture. The Board noted that an entity is generally more involved with joint ventures than with associates because joint control means that the entity has a right of veto over decisions relating to the relevant activities of the joint venture. Accordingly, the different nature of the relationship between a joint venturer and its joint ventures from that between an investor and its associates warrants a different level of detail in the disclosures of summarised financial information.

BC52 The Board also considered the views of some users who suggested that summarised financial information should be required for joint operations. Assets and liabilities arising from joint operations are an entity's assets and liabilities and consequently are recognised in the entity's financial statements. Those assets and liabilities would be accounted for in accordance with the requirements of applicable IFRSs, and would be subject to the relevant disclosure requirements of those IFRSs. Therefore the Board concluded that entities should not be required to provide summarised financial information separately for joint operations.

Commitments

BC53 ED 9 proposed that an entity should disclose any capital commitments that it has relating to its interests in joint arrangements. IAS 31 had similar requirements.

BC54 When discussing responses to ED 9, the Board examined two aspects of the proposals. The first was whether an entity should separately disclose commitments relating to all types of joint arrangements. The second was the need to maintain the adjective 'capital' when referring to commitments.

BC55 In response to concerns raised by respondents to ED 9, the Board reconsidered the proposals to disclose commitments for all types of joint arrangements. Respondents said that disclosure of commitments relating to joint operations would be of limited value because such commitments would be included within the disclosures of the entity itself. The Board was convinced by those reasons and decided not to require separate disclosure of commitments relating to an entity's interests in joint operations.

BC56 Regarding the nature of the commitments to be disclosed, the Board noted that 'capital commitment' is not a defined term in IFRSs. Consequently, 'capital' could potentially be interpreted to restrict the disclosures only to those commitments that would result in the capitalisation of assets. Instead, the Board concluded that the objective of the disclosure requirement was to provide information about all unrecognised commitments that could result in future operating, investing or financing cash outflows, or in any other type of outflow of resources from the entity in relation to its interests in joint ventures. Consequently, the Board decided to remove 'capital' from the requirement to disclose commitments.

Contingent liabilities

BC57 ED 9 carried forward the requirement in IAS 31 regarding contingent liabilities and proposed that an entity should separately disclose contingent liabilities relating to its interests in joint arrangements. The Board reconsidered that proposal in response to concerns raised by respondents to ED 9 who stated that separate disclosure of contingent liabilities relating to joint operations would be of limited value for the reasons noted in paragraph BC55.

BC58 The Board was again convinced by those reasons and, accordingly, decided not to require separate disclosure of contingent liabilities relating to an entity's interests in joint operations.

Disclosure requirements for venture capital organisations, mutual funds, unit trusts or similar entities that have an interest in a joint venture or associate

BC59 IAS 28 and IAS 31 established specific disclosure requirements for an entity that had investments in joint ventures or associates when the entity is a venture capital organisation, mutual fund, unit trust or similar entity, including investment-linked insurance funds. The Board discussed whether IFRS 12 should retain the specific disclosure requirements for those types of entities, or whether the disclosure requirements should be the same for all types of entities with interests in joint ventures or associates.

BC60 With the exception of those disclosures that are required only when using the equity method, the Board concluded that the disclosure requirements for interests in joint ventures and associates should be the same for all entities, regardless of whether those entities are venture capital organisations, mutual funds, unit trusts or similar entities. This decision is consistent with the Board's decision to remove the scope exclusion in IAS 28 and IAS 31 for those entities. The Board decided that such entities that hold interests in joint ventures and associates should not be excluded from the relevant standards. Rather, they are simply permitted to use a different measurement basis (ie fair value) for their investments.

Fair value of investments in joint ventures for which there are published price quotations

BC61 IAS 28 required an entity to disclose the fair value of investments in associates for which published price quotations were available. Such quotations might also be available for joint ventures. Consequently, the Board decided to align this disclosure requirement by requiring an entity to disclose the fair value of investments in joint ventures for which there are published price quotations.

Interests in unconsolidated structured entities

The need for the disclosure requirements

BC62 IAS 27 did not require disclosures relating to interests in unconsolidated entities. The Board was asked by users of financial statements, regulators and others (such as the G20 leaders and the Financial Stability Board) to improve the disclosure requirements for what are often described as 'off balance sheet' activities. Unconsolidated structured entities, particularly securitisation vehicles and asset-backed financings, were identified as forming part of such activities.

BC63 The Board concluded that when an entity has an interest in an unconsolidated structured entity, users of financial statements would benefit from information about the risks to which the entity is exposed from that interest. Such information is relevant in assessing the amount, timing and uncertainty of the entity's future cash flows.

BC64 As proposed in ED 10, IFRS 12 requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, the entity's interest in unconsolidated structured entities.

BC65 Virtually all respondents to ED 10 agreed that there is a need for improved disclosures about an entity's exposure to risk from 'off balance sheet' activities. However, respondents expressed differing views on the nature and amount of information that should be disclosed. Some, including users of financial statements, supported the approach proposed in ED 10 to require disclosure of risks arising from interests in unconsolidated structured entities.

BC66 Other respondents pointed out that an entity can be exposed to the same risks from having interests in all types of entities. Therefore, they questioned why an entity should be required to provide particular information about its exposure to risk from its interests in unconsolidated structured entities, but not with other unconsolidated entities.

BC67 Some respondents were also concerned that the proposals would duplicate the risk disclosures in IFRS 7 *Financial Instruments: Disclosures*. IFRS 7 requires an entity to disclose qualitative and quantitative information about risks arising from financial instruments that the entity holds. Those respondents expressed the view that ED 10 proposed disclosures about the counterparties of financial instruments to which the disclosure requirements in IFRS 7 already apply.

BC68 In addition, some respondents disagreed with the proposals because they suspected that the Board had included the proposed disclosures as a 'safety net' because it was concerned that some structured entities might fail the consolidation criteria in ED 10, even though, in their view, consolidation would be appropriate.

BC69 When deliberating the responses to ED 10, the Board agreed with those respondents who emphasised that disclosures about unconsolidated structured entities cannot replace robust consolidation requirements. The disclosures proposed were never intended to compensate for weaknesses in the control definition. IFRS 10 documents the Board's determination to develop appropriate and robust consolidation criteria. Rather, the disclosure proposals were intended to complement the consolidation criteria, focusing on an entity's exposure to risk from interests in structured entities that the entity rightly does not consolidate because it does not control them.

BC70 The Board acknowledged that the same types of risks that the disclosure proposals in ED 10 were intended to capture can arise from an entity's interests in other types of entities and that it may be appropriate to develop risk disclosures that apply to an entity's interests in all types of unconsolidated entities. However, the Board noted that when it proposed the disclosure requirements in ED 10, it intended to provide a timely response to particular information needs identified during the global financial crisis that started in 2007. More specifically, users and regulators had expressed concerns about the lack of disclosure relating to investment and securitisation activities that an entity conducts through structured entities. They asked the Board to introduce specific risk disclosures for an entity's interests in unconsolidated structured entities because those particular interests had exposed entities to significant risks in the past. The proposed disclosure requirements in ED 10 were intended to meet those requests. To go beyond structured entities would delay addressing the concerns raised, which would not be beneficial to users.

BC71 The Board also noted that addressing disclosures for interests in unconsolidated structured entities would be an opportunity to align the disclosure requirements in IFRSs and US GAAP in this respect.

BC72 Regarding IFRS 7, the Board agreed with respondents that both requirements will often result in disclosure of the same underlying risks. What is different is how the disclosure requirements describe an entity's risk exposure. IFRS 7 requires qualitative and quantitative disclosures about the credit, liquidity, market and other risks associated with financial instruments. IFRS 12 adopts a different perspective and requires an entity to disclose its exposure to risk from its interest in a structured entity.

BC73 The Board believes that information from both perspectives assists users of financial statements in their analysis of an entity's exposure to risk—the disclosures in IFRS 7 by identifying those financial instruments that create risk, and the disclosures in IFRS 12 by providing, when relevant, information about:

(a) the extent of an entity's transactions with structured entities;

(b) concentrations of risk that arise from the nature of the entities with which the entity has transactions; and

(c) particular transactions that expose the entity to risk.

BC74 Accordingly, the Board concluded that although the disclosures in IFRS 7 and IFRS 12 regarding unconsolidated structured entities might overlap to some extent, they complement each other.

BC75 The Board was also persuaded by information received from users of financial statements in the US, who had been using the disclosures required by US GAAP for variable interest entities in their analysis. Those users confirmed that the new disclosures provided them with information that was not previously available to them, but which they regarded as important for a thorough understanding of an entity's exposure to risk.

BC76 Many of those users referred also to the global financial crisis and emphasised that a better understanding of an entity's interests in unconsolidated structured entities might have helped to identify earlier the extent of risks to which entities were exposed. Accordingly, those users stated that the new disclosures had significantly improved the quality of financial reporting and strongly encouraged the Board to require similar disclosures for IFRS preparers.

BC77 The Board considered whether an entity should be required to disclose the information for interests in unconsolidated structured entities as well as for interests in joint ventures or associates if a joint venture or an associate meets the definition of a structured entity. The Board concluded that an entity should provide information that meets both sets of disclosure requirements if it has interests in joint ventures or associates that are structured entities. In reaching this conclusion, the Board noted that an entity should capture most, and in some cases all, of the disclosures required for interests in unconsolidated structured entities by providing the disclosures for interests in joint ventures and associates. Accordingly, the Board does not think that this conclusion should significantly increase the amount of information that an entity would be required to provide.

The scope of the risk disclosures

Interests in unconsolidated structured entities

BC78 In response to concerns raised by respondents to ED 10 about the scope of the risk disclosures, the Board considered whether it should try to define 'interests in' more narrowly, for example, by stating that an entity would be required to disclose information only about interests that give rise to exposure to loss beyond amounts recognised in its financial statements. However, the Board concluded that any such attempt to narrow the definition of 'interests in' would complicate the guidance and would probably exclude disclosure of information that users would find useful.

BC79 The Board also considered whether to require disclosure of significant interests in structured entities—some respondents to ED 10 had suggested clarifying that an entity would not be required to disclose information about insignificant interests with structured entities. The Board decided against adding 'significant' for a number of reasons. First, the Board noted that because the concept of materiality underpins the disclosure requirements in IFRS 12 as it does in all other IFRSs, an entity would be required to disclose only information that is material as defined and described in the *Conceptual Framework*. The Board also noted that the term 'significant' is not defined in IFRSs. Comments received on other projects suggest that 'significant' is interpreted in different ways. The Board concluded that, without defining the term, adding 'significant' would be of no benefit to those using IFRS 12 to prepare or audit financial statements.

BC80 The Board decided to retain the wider definition of 'interest in' (ie an entity's involvement with another entity, whether contractual or non-contractual, that exposes the entity to variability of returns from the performance of the other entity). The Board was convinced by comments received from US preparers, auditors and users about their experience with the US GAAP requirements to disclose information about involvement with variable interest entities. Involvement is not defined by US GAAP but is interpreted in a way similar to how 'interest in' is defined in IFRS 12. US preparers and users generally agreed with the scope of the disclosure requirements—US users of financial statements thought that the revised disclosure requirements provided them with an appropriate degree of detail; US preparers and accountants thought that the disclosure requirements allow entities to focus on presenting information that is considered relevant for users of financial statements.

US preparers and accountants also noted that both the aggregation guidance and the requirement that an entity should determine, in the light of facts and circumstances, how much detail it must give to satisfy the disclosure requirements provide sufficient flexibility for preparers.

BC81 Consequently, the Board decided to include in IFRS 12 the requirement to consider the level of detail necessary to meet the disclosure objectives and to include aggregation principles and guidance to assist preparers when determining what level of detail is appropriate.

The definition of a structured entity

BC82 IFRS 12 introduces the term ‘structured entity’. The type of entity the Board envisages being characterised as a structured entity is unlikely to differ significantly from an entity that SIC-12 *Consolidation—Special Purpose Entities* described as a special purpose entity (SPE). SIC-12 described an SPE as an entity created to accomplish a narrow and well-defined objective, listing as examples entities established to effect a lease, research and development activities or a securitisation of financial assets.

BC83 The Board considered whether to define a structured entity in a way similar to a variable interest entity (VIE) in US GAAP. US GAAP defines a VIE, in essence, as an entity whose activities are not directed through voting or similar rights. In addition, the total equity at risk in a VIE is not sufficient to permit the entity to finance its activities without additional subordinated financial support. US GAAP contains extensive application guidance to help determine the sufficiency of the equity, including a 10 per cent equity threshold that is generally used to determine whether an entity’s equity is sufficient. The Board decided against this approach because it would introduce complicated guidance solely for disclosure purposes that was not previously in IFRSs.

BC84 The Board therefore decided to define a structured entity as an entity that has been designed so that voting rights are not the dominant factor in deciding who controls the entity. The Board also decided to include guidance similar to that included in SIC-12 to reflect the Board’s intention that the term ‘structured entity’ should capture a set of entities similar to SPEs in SIC-12. The Board also decided to incorporate some of the attributes of a VIE included in US GAAP. In particular, a structured entity is an entity whose equity is often not sufficient to permit the entity to finance its activities without additional subordinated financial support. The Board reasoned that users had requested risk disclosures relating to structured entities because being involved with such entities inherently exposes an entity to more risk than being involved with traditional operating entities. The increased risk exposure arises because, for example, the entity has restricted activities, is created to pass risks and returns arising from specified assets to investors, or there is insufficient equity to fund losses on the assets, if they arise.

BC85 The definition does not state that if an entity has insufficient equity at risk, it would always be deemed to be a structured entity. There are two reasons for this. The first is that such a definition would require extensive application guidance to help determine the sufficiency of the equity, similar to US GAAP, to which the Board was opposed for the reasons noted in paragraph BC83. The second is that the Board feared that some traditional operating entities might be caught by such a definition when it had no intention of doing so. For example, a traditional operating entity whose financing had been restructured following a downturn in activities might be deemed to be a structured entity, which was not what the Board intended.

Nature of interest

BC86 IFRS 12 requires an entity to disclose information that enables users of financial statements to understand the nature of, and changes in, the risks associated with its interests in structured entities (see paragraphs BC92–BC114). As a consequence, an entity would be required to provide disclosures about its exposure to risk when it has sponsored an unconsolidated structured entity and has retained an interest in the structured entity, for example by holding debt or equity instruments of the structured entity.

BC87 However, that decision would not require an entity to provide disclosures if the entity does not retain any interest in the structured entity through explicit or implicit involvement. The Board received views from many constituents who reasoned that sponsoring a structured entity can create risks for an entity, even though the entity might not retain any interest in the structured entity. If the structured entity encounters difficulties, it is possible that the sponsor could be challenged on its advice or actions, or might choose to act to protect its reputation.

BC88 IFRS 12 also requires disclosure regarding the provision of financial and other support to a structured entity when there is no contractual obligation to do so and about any current intentions to provide financial support or other assistance in the future (see paragraphs BC102–BC106). Although helpful, the disclosure provides an incomplete picture of an entity's exposure to risk from its sponsoring activities because:

(a) the disclosure requirement applies only when the entity has provided, or intends to provide, financial support to a structured entity.

(b) an entity's exposure to risk from its sponsoring activities is broader than the risk to provide implicit support to the structured entity. For example, an entity that does not intend to provide any implicit support might be exposed to litigation risk from sponsoring a failed structured entity.

(c) there is currently no other disclosure requirement that would inform users of financial statements about an entity's risk exposure from its sponsoring activities. For example, the disclosure requirements in IFRS 7 do not result in such information because there is usually no financial instrument associated with the sponsorship that would trigger the disclosures. The disclosure requirements relating to transfers of financial assets apply only if an entity has transferred its own financial assets to the structured entities that it sponsors. In addition, an unconsolidated structured entity is unlikely to meet the definition of a related party in IAS 24 *Related Party Disclosures*.

BC89 Users said that it would be useful to have information about the scale of an entity's operations that is derived from transactions with unconsolidated structured entities, ie to have more information about an entity's business model and the risks associated with that business model. This would be particularly useful to help understand the likely effect on the performance of an entity attributable to either a loss of income or a restriction on the entity's ability to carry out its usual business activities if there were a significant decrease in the use of structured entities for investing or financing purposes. They noted that during the global financial crisis that started in 2007 investors became concerned about the extent to which entities had been involved with structured investment vehicles. However, few entities disclosed information about the extent of their involvement in establishing such vehicles. It was, therefore, difficult to assess the potential exposure an entity might have. Those users also confirmed that their request for such information precedes the global financial crisis, and is not simply a reaction to it.

BC90 In response to requests from users and others, the Board decided to require an entity to disclose income derived from, and asset information about, structured entities that the entity has sponsored. The Board noted that the requirements are not intended to help assess the actual risk of failure or recourse to an entity. Rather, they would give a sense of the scale of the operations an entity had managed with these types of transactions and the extent of the entity's reliance on such entities to facilitate its business. For this reason, the Board concluded that the asset information disclosed should refer not only to assets transferred by the sponsor but to all assets transferred to the structured entity during the reporting period. The information provided would be a signpost that would enable users to identify when to ask for further information.

BC91 Because an entity is required to disclose information about its exposure to risk when it retains an interest in an unconsolidated structured entity, the Board decided that the requirement to disclose income and asset information when acting as a sponsor should be required only when an entity has not provided disclosures about the nature of its risks from that interest in the unconsolidated structured entity.

Nature of risks

BC92 ED 10 proposed that an entity should disclose information to help users of financial statements evaluate the nature and extent of the entity's risk from its interests in unconsolidated structured entities. To support that objective, the exposure draft proposed that an entity should disclose the carrying amounts of its assets and liabilities relating to its interests in structured entities, its maximum exposure to loss and the reported amount of assets of structured entities. ED 10 also listed other information (such as information about the assets and funding of structured entities) that might be useful to an assessment of the risks to which an entity is exposed.

BC93 Users generally supported the disclosures proposed. However, other respondents to ED 10, although agreeing that risk disclosures were required, thought that the proposed disclosure requirements were too prescriptive. In their view, an entity should be allowed to disclose its risk exposure on the basis of the information generated by its internal risk reporting system rather than on the basis of the information proposed in ED 10.

BC94 Although agreeing with respondents that an entity should generally be allowed to tailor its disclosures to meet the specific information needs of its users, the Board decided that the disclosure requirements should contain a minimum set of requirements that should be applied by all entities. The Board was convinced by comments from users who pointed out that without any specific disclosure requirements, comparability would be impaired and an entity might not disclose information that users find important.

BC95 Users of financial statements confirmed that information about an entity's exposure to loss from its interests in unconsolidated structured entities and supplementary information about the financial position of both the entity and the structured entity is relevant to their analysis of financial statements.

The assets of structured entities

BC96 The Board was persuaded by the views of respondents who argued that disclosure of assets held by structured entities without information about the funding of the assets is of limited use, and could be difficult to interpret. Therefore, the Board decided to require an entity to disclose information about the nature, purpose, size and activities of a structured entity and how the structured entity is financed. The Board concluded that this requirement should provide users with sufficient information about the assets held by structured entities and the funding of those assets, without requiring specific disclosure of the assets of unconsolidated structured entities in which the entity has an interest in all circumstances. If relevant to an assessment of its exposure to risk, an entity would be required to provide additional information about the assets and funding of structured entities.

Exposure to loss

BC97 The Board acknowledged that, sometimes, information about an entity's expected losses might be more relevant than information about its maximum exposure to loss and that the disclosure of either amount would require the application of judgement. However, if IFRS 12 required the disclosure of expected losses only, the Board was concerned that an entity might often identify a positive expected value of returns from its interests in unconsolidated structured entities and, as a consequence, would not disclose any loss exposure. Accordingly, the Board retained the requirement to disclose an entity's maximum exposure to loss from interests in unconsolidated structured entities.

BC98 The Board decided not to provide a definition of what represents a loss but to leave it to an entity to identify what constitutes a loss in the particular context of that reporting entity. The entity should then disclose how it has determined its maximum loss exposure.

BC99 The Board acknowledged that it may not always be possible to calculate the maximum exposure to loss, such as when a financial instrument exposes an entity to theoretically unlimited losses. The Board decided that when this is the case an entity should disclose the reasons why it is not possible to calculate its maximum exposure to loss.

BC100 Lastly, the Board decided to require an entity to disclose a comparison of the carrying amounts of the assets and liabilities in its statement of financial position and its maximum exposure to loss. This is because the information will provide users with a better understanding of the differences between the maximum loss exposure and the expectation of whether it is likely that an entity will bear all or only some of those losses. In the past, maximum exposure to loss information (when it was provided) was often accompanied by a statement that the information did not in any way represent the losses to be incurred. The Board reasoned that this disclosure requirement should help an entity explain why the maximum exposure to loss is unrepresentative of its actual exposure if that is the case.

BC101 The Board also noted that the disclosures required regarding an entity's exposure to loss mirror those required by US GAAP, which have been well received by users of financial statements in the US.

Providing financial support without having an obligation to do so

BC102 ED 10 proposed requiring the disclosure of support that an entity has provided to unconsolidated structured entities without having a contractual obligation to do so.

BC103 Most respondents to ED 10 agreed with the proposed disclosures, noting that an entity's past actions may be an important factor in considering the substance of its relationship with structured entities. Some, however, questioned the proposal to disclose any current intentions to provide support to a structured entity and questioned how to interpret 'support'.

BC104 The Board agreed with those respondents who thought that it would be unreasonable to expect an entity to include forward-looking disclosures about a decision that might be made in the future. However, the Board concluded that IFRS 12 should retain the requirement to disclose any current intentions to provide non-contractual financial or other support because if an entity has decided that it will provide support (ie it has current intentions to do so), this should be disclosed.

BC105 The Board decided not to define 'support' because a definition of support would either be so broad that it would be an ineffective definition or invite structuring so as to avoid the disclosure. The Board believes that financial support is widely understood as a provision of resources to another entity, either directly or indirectly. In the case of implicit arrangements, the support is provided without having the contractual obligation to do so. Nonetheless, the Board decided to include some examples of financial support in IFRS 12. In order to address respondents' concerns about distinguishing this provision of financial support from any other commercial transaction, the Board clarified that the disclosure is required when an entity has provided non-contractual support to an unconsolidated structured entity in which it previously had or currently has an interest.

BC106 The Board also decided to extend the requirement to support provided to both consolidated and unconsolidated structured entities. US GAAP includes this requirement and users confirmed that they find the disclosure of such information useful.

Risks arising from previous involvement with unconsolidated structured entities

BC107 The actions of some entities during the global financial crisis that started in 2007 demonstrated that an entity can have exposure to risk from involvement with a structured entity, even though it may not control or have any contractual involvement with that entity at the reporting date. For example, failure of a structured entity might damage an entity's reputation, compelling the entity to provide support to the structured entity in order to protect its reputation, even though the entity has no legal or contractual requirement to do so.

BC108 The Board considered how best to address requests to improve the disclosure requirements in this area. The difficulty faced by the Board was to determine which disclosures might help assess an entity's exposure to reputational risk in advance of a financial crisis happening.

BC109 The Board considered asking for five-year historical information about the assets transferred to unconsolidated structured entities that the reporting entity had sponsored. However, the Board concluded that historical information beyond that required by paragraph 27 of the IFRS would not necessarily provide any useful information about the risks to which a sponsor is currently exposed. Information at the reporting date about total assets of unconsolidated structured entities that an entity had sponsored might be useful. However, this information would be difficult, if not impossible, for entities to provide because the entity does not control, or have an interest in, the structured entity at the reporting date. The Board also considered whether to ask for additional information when a particular triggering event occurred (for example, when a structured entity holds troubled assets). However, again, the Board rejected such an approach. Requiring additional disclosures only when the triggering event happens would probably yield information that was too late to be useful.

BC110 The Board decided that the objective in this respect is that an entity should provide information about its exposure to risk associated with its interests in structured entities, regardless of whether that risk arises from having an existing interest in the entity or from being involved with the entity in previous periods. Therefore the Board decided to define ‘an interest in an entity’ as contractual or non-contractual involvement that exposes the entity to variability of returns. In addition, the Board decided to state explicitly that the disclosures about an entity’s exposure to risk should include risk that arises from previous involvement with a structured entity even if an entity no longer has any contractual involvement with the structured entity at the end of the reporting period.

Additional information that might be relevant to an assessment of risk

BC111 When the Board included a list of other information that might be relevant to an assessment of risk in ED 10, it did not intend each item in the list of proposed supplemental disclosures to apply in all circumstances, ie no item was intended to be mandatory. Rather, the Board thought that all the proposed disclosures had the potential to provide important information. Depending on a particular set of facts and circumstances, some of the proposed disclosures would be very relevant whereas others would not. Therefore, an entity might be expected to provide some, but not all, of the disclosures included in the list.

BC112 The difficulty facing the Board was that preparers and users generally have differing views about the level of prescriptive detail to include in disclosure requirements. Preparers generally propose having clear disclosure principles but with a limited number of prescriptive disclosure requirements. They believe that each reporting entity should be able to determine what information meets the disclosure principles on the basis of the particular facts and circumstances surrounding the entity. Users, on the other hand, prefer to have prescriptive disclosure requirements so that the information provided by preparers is comparable.

BC113 The Board’s intentions regarding the disclosure of exposure to risk is for an entity to disclose information that is important when assessing that exposure, but not to cloud the information with unnecessary detail that would be considered irrelevant. If an entity has a large exposure to risk because of transactions with a particular unconsolidated structured entity, then the Board would expect extensive disclosure about that exposure. In contrast, if the entity has very limited exposure to risk, little disclosure would be required.

BC114 The Board decided to retain a list of examples of disclosures that might be relevant to emphasise the level of detail that would be required when an entity has a large exposure to risk from its interests in unconsolidated structured entities. However, the Board decided to make clear that the list of additional information that, depending on the circumstances, might be relevant is a list of examples of information that might be relevant and not a list of requirements that should be applied regardless of the circumstances.

Effective date and transition

BC115 The Board decided to align the effective date for the IFRS with the effective date for IFRS 10, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. When making this decision, the Board noted that the five IFRSs all deal with the assessment of, and related accounting and disclosure requirements about, a reporting entity's special relationships with other entities (ie when the reporting entity has control or joint control of, or significant influence over, another entity). As a result, the Board concluded that applying IFRS 12 without also applying the other four IFRSs could cause unwarranted confusion.

BC116 The Board usually sets an effective date of between twelve and eighteen months after issuing an IFRS. When deciding the effective date for those IFRSs, the Board considered the following factors:

(a) the time that many countries require for translation and for introducing the mandatory requirements into law.

(b) the consolidation project was related to the global financial crisis that started in 2007 and was accelerated by the Board in response to urgent requests from the leaders of the G20, the Financial Stability Board, users of financial statements, regulators and others to improve the accounting and disclosure of an entity's 'off balance sheet' activities.

(c) the comments received from respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 regarding implementation costs, effective date and transition requirements of the IFRSs to be issued in 2011. Most respondents did not identify the consolidation and joint arrangements IFRSs as having a high impact in terms of the time and resources that their implementation would require. In addition, only a few respondents commented that the effective dates of those IFRSs should be aligned with those of the other IFRSs to be issued in 2011.

BC117 With those factors in mind, the Board decided to require entities to apply the five IFRSs for annual periods beginning on or after 1 January 2013.

BC118 Most respondents to the Request for Views supported early application of the IFRSs to be issued in 2011. Respondents stressed that early application was especially important for first-time adopters in 2011 and 2012. The Board was persuaded by these arguments and decided to permit early application of the five IFRSs (ie IFRS 10, IFRS 11, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011)) but only if an entity applies all those IFRSs.

BC119 Notwithstanding that decision, the Board noted that an entity should not be prevented from providing any information required by IFRS 12 early if by doing so users gained a better understanding of the entity's relationships with other entities. In reaching that decision, the Board observed that if an entity chooses to apply some, but not all, of the requirements of IFRS 12 early, the entity would be required to continue to apply the disclosure requirements of IAS 27, IAS 28 and IAS 31 until such time that it applies all the requirements of IFRS 12.

Summary of main changes from ED 9 and ED 10

BC120 The main changes from the exposure drafts ED 9 and ED 10 are:

(a) The disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities are included in IFRS 12, separately from the accounting requirements relating to an entity's interests in those entities. ED 9 and ED 10 had proposed that the disclosure requirements would be located with the accounting requirements in IAS 28, IFRS 10 and IFRS 11. (paragraphs BC7 and BC8)

(b) IFRS 12 includes application guidance dealing with the aggregation of information disclosed in accordance with the requirements of the IFRS.

(c) IFRS 12 requires the disclosure of significant judgements and assumptions made in determining whether an entity has a special relationship (ie control, joint control or significant influence) with another entity. ED 10 had proposed disclosure of the basis of an entity's assessment of whether it controls another entity in particular scenarios. (paragraphs BC14–BC19)

(d) IFRS 12 requires the disclosure of summarised financial information for subsidiaries that have non-controlling interests that are material to the entity. ED 9 had proposed disclosing a list of significant subsidiaries. (paragraphs BC21–BC29)

(e) IFRS 12 requires disclosure of the nature of, and risks associated with, an entity's interests in consolidated structured entities. (paragraphs BC34–BC36)

(f) IFRS 12 requires the disclosure of summarised financial information for each material joint venture and associate, and requires more detailed information for joint ventures than for associates. ED 9 had proposed less detailed summarised financial information for each material joint venture and summarised financial information in aggregate for associates. (paragraphs BC47–BC52)

(g) IFRS 12 requires entities that are venture capital organisations, mutual funds, unit trusts and similar entities to provide all the disclosures relating to interests in joint ventures and associates. ED 9 proposed that such entities would be required to provide only some of the disclosures relating to interests in joint ventures and associates. (paragraphs BC59 and BC60)

(h) IFRS 12 does not require the disclosure of the reported amount of assets held by structured entities in which an entity has an interest. ED 10 had proposed disclosing such information. (paragraph BC96)

Convergence with US GAAP

BC121 Most of the disclosure requirements for consolidated and unconsolidated structured entities are similar to those for variable interest entities in Subtopic 810-10 in the *FASB Accounting Standards Codification®*. The Board developed many of those disclosure requirements in conjunction with the FASB, following the Financial Stability Board's recommendation to work with other accounting standard-setters to achieve international convergence in this area. However, IFRS 12 goes further than the disclosure requirements in Subtopic 810-10 because it requires an entity to disclose information about:

(a) the interest that non-controlling interests have in the activities of a consolidated structured entity; and

(b) the risks from sponsoring an unconsolidated structured entity for which the entity does not provide other risk disclosures.

BC122 IFRS 12 also includes more detailed disclosure requirements than US GAAP for subsidiaries, joint arrangements and associates (eg summarised financial information for subsidiaries with material non-controlling interests, and material joint ventures and associates).

Cost-benefit considerations

BC123 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. To attain this objective, the Board seeks to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs to implement a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC124 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considers the following:

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

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

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

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

(e) the costs of transition for users, preparers and others.

BC125 The Board observed that IFRS 12 will improve the ability of users to understand consolidated financial statements by requiring disclosure of information about the interests that non-controlling interests have in the group's activities. IFRS 12 will also improve users' understanding of the special relationships that a reporting entity has with entities that are not consolidated (ie the relationships with joint arrangements, associates and unconsolidated structured entities).

BC126 In particular, an entity was not previously required to provide information specifically about its exposure to risk from interests in structured entities. The requirements in IFRS 12 relating to interests in unconsolidated structured entities respond to the conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board following the global financial crisis that started in 2007. The G20 leaders and the Financial Stability Board recommended that the IASB should accelerate its work on enhancing disclosure requirements for 'off balance sheet' vehicles (such as structured investment vehicles), in particular to ensure that entities are required to disclose their exposure to risk and potential losses associated with their involvement with such vehicles.

BC127 During the development of IFRS 12, the Board consulted users of financial statements, who confirmed the benefit of having more information about:

(a) an entity's exposure to risk from interests in structured entities;

(b) non-controlling interests within the group; and

(c) joint arrangements and associates.

BC128 There are costs involved in the adoption and ongoing application of IFRS 12. Those costs will depend on the nature and complexity of the relationships that a reporting entity has with other entities. However, given the benefits for users noted in paragraphs BC125–BC127, the Board believes that the benefits of IFRS 12 outweigh the costs.

HKFRS 13
Issued June 2011

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 13

Fair Value Measurement

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

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Hong Kong Financial Reporting Standard 13 *Fair Value Measurement* (HKFRS 13) is set out in paragraphs 1–99 and Appendices A–D. 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. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 13 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Overview

IN1 Hong Kong Financial Reporting Standard 13 *Fair Value Measurement* (HKFRS 13):

(a) defines fair value;

(b) sets out in a single HKFRS a framework for measuring fair value; and

(c) requires disclosures about fair value measurements.

IN2 The HKFRS applies to HKFRSs that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances.

IN3 The HKFRS is to be applied for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

IN4 The HKFRS explains how to measure fair value for financial reporting. It does not require fair value measurements in addition to those already required or permitted by other HKFRSs and is not intended to establish valuation standards or affect valuation practices outside financial reporting.

Reasons for issuing the HKFRS

IN5 Some HKFRSs require or permit entities to measure or disclose the fair value of assets, liabilities or their own equity instruments. Because those HKFRSs were developed over many years, the requirements for measuring fair value and for disclosing information about fair value measurements were dispersed and in many cases did not articulate a clear measurement or disclosure objective.

IN6 As a result, some of those HKFRSs contained limited guidance about how to measure fair value, whereas others contained extensive guidance and that guidance was not always consistent across those HKFRSs that refer to fair value. Inconsistencies in the requirements for measuring fair value and for disclosing information about fair value measurements have contributed to diversity in practice and have reduced the comparability of information reported in financial statements. HKFRS 13 remedies that situation.

IN7 Furthermore, in 2006 the International Accounting Standards Board (IASB) and the US national standard-setter, the Financial Accounting Standards Board (FASB), published a Memorandum of Understanding, which has served as the foundation of the boards' efforts to create a common set of high quality global accounting standards. Consistent with the Memorandum of Understanding and the boards' commitment to achieving that goal, IFRS 13 (that is, the international equivalent of HKFRS 13) is the result of the work by the IASB and the FASB to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with IFRSs and US generally accepted accounting principles (GAAP).

Main features

IN8 HKFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price).

IN9 That definition of fair value emphasises that fair value is a market-based measurement, not an entity-specific measurement. When measuring fair value, an entity uses the assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

IN10 The HKFRS explains that a fair value measurement requires an entity to determine the following:

(a) the particular asset or liability being measured;

(b) for a non-financial asset, the highest and best use of the asset and whether the asset is used in combination with other assets or on a stand-alone basis;

(c) the market in which an orderly transaction would take place for the asset or liability; and

(d) the appropriate valuation technique(s) to use when measuring fair value. The valuation technique(s) used should maximise the use of relevant observable inputs and minimise unobservable inputs. Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability.

Hong Kong Financial Reporting Standard 13
Fair Value Measurement

Objective

1 This HKFRS:

(a) defines *fair value*;

(b) sets out in a single HKFRS a framework for measuring fair value; and

(c) requires disclosures about fair value measurements.

2 Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions (ie an *exit price* at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

3 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant *observable inputs* and minimises the use of *unobservable inputs*. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

4 The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this HKFRS shall be applied to an entity's own equity instruments measured at fair value.

Scope

5 This HKFRS applies when another HKFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except as specified in paragraphs 6 and 7.

6 The measurement and disclosure requirements of this HKFRS do not apply to the following:

(a) share-based payment transactions within the scope of HKFRS 2 *Share-based Payment*;

(b) leasing transactions within the scope of HKAS 17 *Leases*; and

(c) measurements that have some similarities to fair value but are not fair value, such as net realisable value in HKAS 2 *Inventories* or value in use in HKAS 36 *Impairment of Assets*.

7 The disclosures required by this HKFRS are not required for the following:

(a) plan assets measured at fair value in accordance with HKAS 19 *Employee Benefits*;

(b) retirement benefit plan investments measured at fair value in accordance with HKAS 26 *Accounting and Reporting by Retirement Benefit Plans*; and

(c) assets for which recoverable amount is fair value less costs of disposal in accordance with HKAS 36.

8 The fair value measurement framework described in this HKFRS applies to both initial and subsequent measurement if fair value is required or permitted by other HKFRSs.

Measurement

Definition of fair value

9 This HKFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

10 Paragraph B2 describes the overall fair value measurement approach.

The asset or liability

11 A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

(a) the condition and location of the asset; and

(b) restrictions, if any, on the sale or use of the asset.

12 The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.

13 The asset or liability measured at fair value might be either of the following:

(a) a stand-alone asset or liability (eg a financial instrument or a non-financial asset); or

(b) a group of assets, a group of liabilities or a group of assets and liabilities (eg a cash-generating unit or a business).

14 Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset or liability shall be determined in accordance with the HKFRS that requires or permits the fair value measurement, except as provided in this HKFRS.

The transaction

15 A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

16 A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(a) in the *principal market* for the asset or liability; or

(b) in the absence of a principal market, in the *most advantageous market* for the asset or liability.

17 An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

18 If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

19 The entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and businesses within those entities) with different activities may have access to different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and businesses within those entities). Therefore, the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.

20 Although an entity must be able to access the market, the entity does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.

21 Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

Market participants

22 An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

23 In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to all the following:

(a) the asset or liability;

(b) the principal (or most advantageous) market for the asset or liability; and

(c) market participants with whom the entity would enter into a transaction in that market.

The price

24 Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

25 The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for *transaction costs*. Transaction costs shall be accounted for in accordance with other HKFRSs. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how an entity enters into a transaction for the asset or liability.

26 Transaction costs do not include *transport costs*. If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

Application to non-financial assets

Highest and best use for non-financial assets

27 A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its *highest and best* use or by selling it to another market participant that would use the asset in its highest and best use.

28 The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).

(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

29 Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

30 To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. For example, that might be the case for an acquired intangible asset that the entity plans to use defensively by preventing others from using it. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

Valuation premise for non-financial assets

31 The highest and best use of a non-financial asset establishes the valuation premise used to measure the fair value of the asset, as follows:

(a) The highest and best use of a non-financial asset might provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (eg a business).

(i) If the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (ie its complementary assets and the associated liabilities) would be available to market participants.

(ii) Liabilities associated with the asset and with the complementary assets include liabilities that fund working capital, but do not include liabilities used to fund assets other than those within the group of assets.

(iii) Assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used.

(b) The highest and best use of a non-financial asset might provide maximum value to market participants on a stand-alone basis. If the highest and best use of the asset is to use it on a stand-alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a stand-alone basis.

32 The fair value measurement of a non-financial asset assumes that the asset is sold consistently with the unit of account specified in other HKFRSs (which may be an individual asset). That is the case even when that fair value measurement assumes that the highest and best use of the asset is to use it in combination with other assets or with other assets and liabilities because a fair value measurement assumes that the market participant already holds the complementary assets and the associated liabilities.

33 Paragraph B3 describes the application of the valuation premise concept for non-financial assets.

Application to liabilities and an entity's own equity instruments

General principles

34 A fair value measurement assumes that a financial or non-financial liability or an entity's own equity instrument (eg equity interests issued as consideration in a business combination) is transferred to a market participant at the measurement date. The transfer of a liability or an entity's own equity instrument assumes the following:

(a) A liability would remain outstanding and the market participant transferee would be required to fulfil the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.

(b) An entity's own equity instrument would remain outstanding and the market participant transferee would take on the rights and responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.

35 Even when there is no observable market to provide pricing information about the transfer of a liability or an entity's own equity instrument (eg because contractual or other legal restrictions prevent the transfer of such items), there might be an observable market for such items if they are held by other parties as assets (eg a corporate bond or a call option on an entity's shares).

36 In all cases, an entity shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs to meet the objective of a fair value measurement, which is to estimate the price at which an orderly transaction to transfer the liability or equity instrument would take place between market participants at the measurement date under current market conditions.

Liabilities and equity instruments held by other parties as assets

37 When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date.

38 In such cases, an entity shall measure the fair value of the liability or equity instrument as follows:

(a) using the quoted price in an *active market* for the identical item held by another party as an asset, if that price is available.

(b) if that price is not available, using other observable inputs, such as the quoted price in a market that is not active for the identical item held by another party as an asset.

(c) if the observable prices in (a) and (b) are not available, using another valuation technique, such as:

(i) an *income approach* (eg a present value technique that takes into account the future cash flows that a market participant would expect to receive from holding the liability or equity instrument as an asset; see paragraphs B10 and B11).

(ii) a *market approach* (eg using quoted prices for similar liabilities or equity instruments held by other parties as assets; see paragraphs B5–B7).

39 An entity shall adjust the quoted price of a liability or an entity's own equity instrument held by another party as an asset only if there are factors specific to the asset that are not applicable to the fair value measurement of the liability or equity instrument. An entity shall ensure that the price of the asset does not reflect the effect of a restriction preventing the sale of that asset. Some factors that may indicate that the quoted price of the asset should be adjusted include the following:

(a) The quoted price for the asset relates to a similar (but not identical) liability or equity instrument held by another party as an asset. For example, the liability or equity instrument may have a particular characteristic (eg the credit quality of the issuer) that is different from that reflected in the fair value of the similar liability or equity instrument held as an asset.

(b) The unit of account for the asset is not the same as for the liability or equity instrument. For example, for liabilities, in some cases the price for an asset reflects a combined price for a package comprising both the amounts due from the issuer and a third-party credit enhancement. If the unit of account for the liability is not for the combined package, the objective is to measure the fair value of the issuer's liability, not the fair value of the combined package. Thus, in such cases, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement.

Liabilities and equity instruments not held by other parties as assets

40 When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is not held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

41 For example, when applying a present value technique an entity might take into account either of the following:

(a) the future cash outflows that a market participant would expect to incur in fulfilling the obligation, including the compensation that a market participant would require for taking on the obligation (see paragraphs B31–B33).

(b) the amount that a market participant would receive to enter into or issue an identical liability or equity instrument, using the assumptions that market participants would use when pricing the identical item (eg having the same credit characteristics) in the principal (or most advantageous) market for issuing a liability or an equity instrument with the same contractual terms.

Non-performance risk

42 The fair value of a liability reflects the effect of *non-performance risk*. Non-performance risk includes, but may not be limited to, an entity's own credit risk (as defined in HKFRS 7 *Financial Instruments: Disclosures*). Non-performance risk is assumed to be the same before and after the transfer of the liability.

43 When measuring the fair value of a liability, an entity shall take into account the effect of its credit risk (credit standing) and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example:

(a) whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability).

(b) the terms of credit enhancements related to the liability, if any.

44 The fair value of a liability reflects the effect of non-performance risk on the basis of its unit of account. The issuer of a liability issued with an inseparable third-party credit enhancement that is accounted for separately from the liability shall not include the effect of the credit enhancement (eg a third-party guarantee of debt) in the fair value measurement of the liability. If the credit enhancement is accounted for separately from the liability, the issuer would take into account its own credit standing and not that of the third party guarantor when measuring the fair value of the liability.

Restriction preventing the transfer of a liability or an entity's own equity instrument

45 When measuring the fair value of a liability or an entity's own equity instrument, an entity shall not include a separate input or an adjustment to other *inputs* relating to the existence of a restriction that prevents the transfer of the item. The effect of a restriction that prevents the transfer of a liability or an entity's own equity instrument is either implicitly or explicitly included in the other inputs to the fair value measurement.

46 For example, at the transaction date, both the creditor and the obligor accepted the transaction price for the liability with full knowledge that the obligation includes a restriction that prevents its transfer. As a result of the restriction being included in the transaction price, a separate input or an adjustment to an existing input is not required at the transaction date to reflect the effect of the restriction on transfer. Similarly, a separate input or an adjustment to an existing input is not required at subsequent measurement dates to reflect the effect of the restriction on transfer.

Financial liability with a demand feature

47 The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

48 An entity that holds a group of financial assets and financial liabilities is exposed to market risks (as defined in HKFRS 7) and to the credit risk (as defined in HKFRS 7) of each of the counterparties. If the entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the entity is permitted to apply an exception to this HKFRS for measuring fair value. That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie an asset) for a particular risk exposure or to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

49 An entity is permitted to use the exception in paragraph 48 only if the entity does all the following:

(a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy;

(b) provides information on that basis about the group of financial assets and financial liabilities to the entity's key management personnel, as defined in HKAS 24 *Related Party Disclosures*; and

(c) is required or has elected to measure those financial assets and financial liabilities at fair value in the statement of financial position at the end of each reporting period.

50 The exception in paragraph 48 does not pertain to financial statement presentation. In some cases the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of financial instruments, for example, if an HKFRS does not require or permit financial instruments to be presented on a net basis. In such cases an entity may need to allocate the portfolio-level adjustments (see paragraphs 53–56) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure. An entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

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

52 The exception in paragraph 48 applies only to financial assets and financial liabilities within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement* or HKFRS 9 *Financial Instruments*.

Exposure to market risks

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

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

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

Exposure to the credit risk of a particular counterparty

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

Fair value at initial recognition

57 When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an *entry price*). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

58 In many cases the transaction price will equal the fair value (eg that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).

59 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. Paragraph B4 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition.

60 If another HKFRS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that HKFRS specifies otherwise.

Valuation techniques

61 An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the *cost approach* and the income approach. The main aspects of those approaches are summarised in paragraphs B5–B11. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.

63 In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

64 If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (eg there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect

observable market data (eg the price for a similar asset or liability) at the measurement date.

65 Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (eg a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place:

(a) new markets develop;

(b) new information becomes available;

(c) information previously used is no longer available;

(d) valuation techniques improve; or

(e) market conditions change.

66 Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with HKAS 8. However, the disclosures in HKAS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Inputs to valuation techniques

General principles

67 Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

68 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include exchange markets, dealer markets, brokered markets and principal-to-principal markets (see paragraph B34).

69 An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs 11 and 12). In some cases those characteristics result in the application of an adjustment, such as a premium or discount (eg a control premium or non-controlling interest discount). However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the HKFRS that requires or permits the fair value measurement (see paragraphs 13 and 14). Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph 80) rather than as a characteristic of the asset or liability (eg a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement. In all cases, if there is a quoted price in an active market (ie a *Level 1 input*) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value, except as specified in paragraph 79.

Inputs based on bid and ask prices

70 If an asset or a liability measured at fair value has a bid price and an ask price (eg an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy (ie Level 1, 2 or 3; see paragraphs 72–90). The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required.

71 This HKFRS does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

Fair value hierarchy

72 To increase consistency and comparability in fair value measurements and related disclosures, this HKFRS establishes a fair value hierarchy that categorises into three levels (see paragraphs 76–90) the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (*Level 3 inputs*).

73 In some cases, the inputs used to measure the fair value of an asset or a liability might be categorised within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, taking into account factors specific to the asset or liability. Adjustments to arrive at measurements based on fair value, such as costs to sell when measuring fair value less costs to sell, shall not be taken into account when determining the level of the fair value hierarchy within which a fair value measurement is categorised.

74 The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques (see paragraph 61). However, the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorised within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorised.

75 If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorised within Level 3 of the fair value hierarchy. For example, if a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a *Level 2 input* and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorised within Level 3 of the fair value hierarchy.

Level 1 inputs

76 **Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.**

77 A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79.

78 A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (eg on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

(a) the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability; and

(b) whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.

79 An entity shall not make an adjustment to a Level 1 input except in the following circumstances:

(a) when an entity holds a large number of similar (but not identical) assets or liabilities (eg debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (ie given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date). In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(b) when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(c) when measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph 39). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorised within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorised within a lower level of the fair value hierarchy.

80 If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 inputs

81 Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

82 If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability, for example:

(i) interest rates and yield curves observable at commonly quoted intervals;

(ii) implied volatilities; and

(iii) credit spreads.

(d) *market-corroborated inputs*.

83 Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

(a) the condition or location of the asset;

(b) the extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph 39); and

(c) the volume or level of activity in the markets within which the inputs are observed.

84 An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorised within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs.

85 Paragraph B35 describes the use of Level 2 inputs for particular assets and liabilities.

Level 3 inputs

86 Level 3 inputs are unobservable inputs for the asset or liability.

87 Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

88 Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (eg when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value, as described in paragraphs B37–B47).

89 An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

90 Paragraph B36 describes the use of Level 3 inputs for particular assets and liabilities.

Disclosure

91 An entity shall disclose information that helps users of its financial statements assess both of the following:

(a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

92 To meet the objectives in paragraph 91, an entity shall consider all the following:

(a) the level of detail necessary to satisfy the disclosure requirements;

(b) how much emphasis to place on each of the various requirements;

(c) how much aggregation or disaggregation to undertake; and

(d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this HKFRS and other HKFRSs are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives.

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this HKFRS) in the statement of financial position after initial recognition:

(a) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement. Recurring fair value measurements of assets or liabilities are those that other HKFRSs require or permit in the statement of financial position at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other HKFRSs require or permit in the statement of financial position in particular circumstances (eg when an entity measures an asset held for sale at fair value less costs to sell in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* because the asset's fair value less costs to sell is lower than its carrying amount).

(b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

(c) for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

(d) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

(e) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

(i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised.

(ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised.

(iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately).

(iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(f) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.

(g) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).

(h) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:

(i) for all such measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with (d).

(ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

94 An entity shall determine appropriate classes of assets and liabilities on the basis of the following:

(a) the nature, characteristics and risks of the asset or liability; and

(b) the level of the fair value hierarchy within which the fair value measurement is categorised.

The number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. However, an entity shall provide information sufficient to permit reconciliation to the line items presented in the statement of financial position. If another HKFRS specifies the class for an asset or a liability, an entity may use that class in providing the disclosures required in this HKFRS if that class meets the requirements in this paragraph.

95 An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with paragraph 93(c) and (e)(iv). The policy about the timing of recognising transfers shall be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:

(a) the date of the event or change in circumstances that caused the transfer.

(b) the beginning of the reporting period.

(c) the end of the reporting period.

96 If an entity makes an accounting policy decision to use the exception in paragraph 48, it shall disclose that fact.

97 For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by paragraph 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this HKFRS.

98 For a liability measured at fair value and issued with an inseparable third-party credit enhancement, an issuer shall disclose the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability.

99 An entity shall present the quantitative disclosures required by this HKFRS in a tabular format unless another format is more appropriate.

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

active market	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
cost approach	A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
entry price	The price paid to acquire an asset or received to assume a liability in an exchange transaction.
exit price	The price that would be received to sell an asset or paid to transfer a liability.
expected cash flow	The probability-weighted average (ie mean of the distribution) of possible future cash flows.
fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
highest and best use	The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used.
income approach	Valuation techniques that convert future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
inputs	The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following: (a) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and (b) the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable.
Level 1 inputs	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
Level 2 inputs	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs	Unobservable inputs for the asset or liability.
market approach	A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.
market-corroborated inputs	Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
market participants	Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics: (a) They are independent of each other, ie they are not related parties as defined in HKAS 24, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms. (b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary. (c) They are able to enter into a transaction for the asset or liability. (d) They are willing to enter into a transaction for the asset or liability, ie they are motivated but not forced or otherwise compelled to do so.
most advantageous market	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.
non-performance risk	The risk that an entity will not fulfil an obligation. Non-performance risk includes, but may not be limited to, the entity's own credit risk.
observable inputs	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.
orderly transaction	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (eg a forced liquidation or distress sale).
principal market	The market with the greatest volume and level of activity for the asset or liability.

risk premium Compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a 'risk adjustment'.

transaction costs The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:

(a) They result directly from and are essential to that transaction.

(b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made (similar to costs to sell, as defined in HKFRS 5).

transport costs The costs that would be incurred to transport an asset from its current location to its principal (or most advantageous) market.

unit of account The level at which an asset or a liability is aggregated or disaggregated in a HKFRS for recognition purposes.

unobservable inputs Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

Appendix B
Application guidance

This appendix is an integral part of the HKFRS. It describes the application of paragraphs 1–99 and has the same authority as the other parts of the HKFRS.

B1 The judgements applied in different valuation situations may be different. This appendix describes the judgements that might apply when an entity measures fair value in different valuation situations.

The fair value measurement approach

B2 The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:

(a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).

(b) for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).

(c) the principal (or most advantageous) market for the asset or liability.

(d) the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Valuation premise for non-financial assets (paragraphs 31–33)

B3 When measuring the fair value of a non-financial asset used in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (eg a business), the effect of the valuation premise depends on the circumstances. For example:

(a) the fair value of the asset might be the same whether the asset is used on a stand-alone basis or in combination with other assets or with other assets and liabilities. That might be the case if the asset is a business that market participants would continue to operate. In that case, the transaction would involve valuing the business in its entirety. The use of the assets as a group in an ongoing business would generate synergies that would be available to market participants (ie market participant synergies that, therefore, should affect the fair value of the asset on either a stand-alone basis or in combination with other assets or with other assets and liabilities).

(b) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through adjustments to the value of the asset used on a stand-alone basis. That might be the case if the asset is a machine and the fair value measurement is determined using an observed price for a similar machine (not installed or otherwise configured for use), adjusted for transport and installation costs so that the fair value measurement reflects the current condition and location of the machine (installed and configured for use).

(c) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through the market participant assumptions used to measure the fair value of the asset. For example, if the asset is work in progress inventory that is unique and market participants would convert the inventory into finished goods, the fair value of the inventory would assume that market participants have acquired or would acquire any specialised machinery necessary to convert the inventory into finished goods.

(d) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the valuation technique used to measure the fair value of the asset. That might be the case when using the multi-period excess earnings method to measure the fair value of an intangible asset because that valuation technique specifically takes into account the contribution of any complementary assets and the associated liabilities in the group in which such an intangible asset would be used.

(e) in more limited situations, when an entity uses an asset within a group of assets, the entity might measure the asset at an amount that approximates its fair value when allocating the fair value of the asset group to the individual assets of the group. That might be the case if the valuation involves real property and the fair value of improved property (ie an asset group) is allocated to its component assets (such as land and improvements).

Fair value at initial recognition (paragraphs 57–60)

B4 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:

(a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.

(b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

(c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (eg in a business combination), the transaction includes unstated rights and privileges that are measured separately in accordance with another HKFRS, or the transaction price includes transaction costs.

(d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

Valuation techniques (paragraphs 61–66)

Market approach

B5 The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.

B6 For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

B7 Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

Cost approach

B8 The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

B9 From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

Income approach

B10 The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

B11 Those valuation techniques include, for example, the following:

(a) present value techniques (see paragraphs B12–B30);

(b) option pricing models, such as the Black-Scholes-Merton formula or a binomial model (ie a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and

(c) the multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

Present value techniques

B12 Paragraphs B13–B30 describe the use of present value techniques to measure fair value. Those paragraphs focus on a discount rate adjustment technique and an *expected cash flow* (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (eg whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

The components of a present value measurement

B13 Present value (ie an application of the income approach) is a tool used to link future amounts (eg cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date:

(a) an estimate of future cash flows for the asset or liability being measured.

(b) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows.

(c) the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (ie a risk-free interest rate).

(d) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium).

(e) other factors that market participants would take into account in the circumstances.

(f) for a liability, the non-performance risk relating to that liability, including the entity's (ie the obligor's) own credit risk.

General principles

B14 Present value techniques differ in how they capture the elements in paragraph B13. However, all the following general principles govern the application of any present value technique used to measure fair value:

(a) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability.

(b) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured.

(c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (ie a discount rate adjustment technique). That same rate should not be used if using expected (ie probability-weighted) cash flows (ie an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.

(d) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.

(e) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

Risk and uncertainty

B15 A fair value measurement using present value techniques is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases both the amount and timing of the cash flows are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is risk of default.

B16 Market participants generally seek compensation (ie a risk premium) for bearing the uncertainty inherent in the cash flows of an asset or a liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient reason to exclude a risk premium.

B17 Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:

(a) The discount rate adjustment technique (see paragraphs B18–B22) uses a risk-adjusted discount rate and contractual, promised or most likely cash flows.

(b) Method 1 of the expected present value technique (see paragraph B25) uses risk-adjusted expected cash flows and a risk-free rate.

(c) Method 2 of the expected present value technique (see paragraph B26) uses expected cash flows that are not risk-adjusted and a discount rate adjusted to include the risk premium that market participants require. That rate is different from the rate used in the discount rate adjustment technique.

Discount rate adjustment technique

B18 The discount rate adjustment technique uses a single set of cash flows from the range of possible estimated amounts, whether contractual or promised (as is the case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (eg contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (ie a market rate of return).

B19 The discount rate adjustment technique requires an analysis of market data for comparable assets or liabilities. Comparability is established by considering the nature of the cash flows (eg whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (eg credit standing, collateral, duration, restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the asset or liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yield curve (ie using a 'build-up' approach).

B20 To illustrate a build-up approach, assume that Asset A is a contractual right to receive CU800[*] in one year (ie there is no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

(a) Asset B is a contractual right to receive CU1,200 in one year and has a market price of CU1,083. Thus, the implied annual rate of return (ie a one-year market rate of return) is 10.8 per cent [(CU1,200/CU1,083) – 1].

(b) Asset C is a contractual right to receive CU700 in two years and has a market price of CU566. Thus, the implied annual rate of return (ie a two-year market rate of return) is 11.2 per cent [(CU700/CU566)^0.5 – 1].

(c) All three assets are comparable with respect to risk (ie dispersion of possible pay-offs and credit).

B21 On the basis of the timing of the contractual payments to be received for Asset A relative to the timing for Asset B and Asset C (ie one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (CU800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset A is CU722 (CU800/1.108). Alternatively, in the absence of available market information for Asset B, the one-year market rate could be derived from Asset C using the build-up approach. In that case the two-year market rate indicated by Asset C (11.2 per cent) would be adjusted to a one-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

B22 When the discount rate adjustment technique is applied to fixed receipts or payments, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed receipts or payments, an adjustment to the cash flows may be necessary to achieve comparability with the observed asset or liability from which the discount rate is derived.

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

Expected present value technique

B23 The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (ie the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).

B24 In making an investment decision, risk-averse market participants would take into account the risk that the actual cash flows may differ from the expected cash flows. Portfolio theory distinguishes between two types of risk:

(a) unsystematic (diversifiable) risk, which is the risk specific to a particular asset or liability.

(b) systematic (non-diversifiable) risk, which is the common risk shared by an asset or a liability with the other items in a diversified portfolio.

Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic risk inherent in the cash flows. (In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)

B25 Method 1 of the expected present value technique adjusts the expected cash flows of an asset for systematic (ie market) risk by subtracting a cash risk premium (ie risk-adjusted expected cash flows). Those risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-free interest rate. A certainty-equivalent cash flow refers to an expected cash flow (as defined), adjusted for risk so that a market participant is indifferent to trading a certain cash flow for an expected cash flow. For example, if a market participant was willing to trade an expected cash flow of CU1,200 for a certain cash flow of CU1,000, the CU1,000 is the certainty equivalent of the CU1,200 (ie the CU200 would represent the cash risk premium). In that case the market participant would be indifferent as to the asset held.

B26 In contrast, Method 2 of the expected present value technique adjusts for systematic (ie market) risk by applying a risk premium to the risk-free interest rate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-weighted cash flows (ie an expected rate of return). Models used for pricing risky assets, such as the capital asset pricing model, can be used to estimate the expected rate of return. Because the discount rate used in the discount rate adjustment technique is a rate of return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.

B27 To illustrate Methods 1 and 2, assume that an asset has expected cash flows of CU780 in one year determined on the basis of the possible cash flows and probabilities shown below. The applicable risk-free interest rate for cash flows with a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

Possible cash flows	**Probability**	**Probability-weighted cash flows**
CU500	15%	CU75
CU800	60%	CU480
CU900	25%	CU225
Expected cash flows		CU780

B28 In this simple illustration, the expected cash flows (CU780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realised cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (eg changes in external factors, including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), taking into account the assumptions of market participants.

B29 In theory, the present value (ie the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2, as follows:

(a) Using Method 1, the expected cash flows are adjusted for systematic (ie market) risk. In the absence of market data directly indicating the amount of the risk adjustment, such adjustment could be derived from an asset pricing model using the concept of certainty equivalents. For example, the risk adjustment (ie the cash risk premium of CU22) could be determined using the systematic risk premium of 3 per cent (CU780 – [CU780 × (1.05/1.08)]), which results in risk-adjusted expected cash flows of CU758 (CU780 – CU22). The CU758 is the certainty equivalent of CU780 and is discounted at the risk-free interest rate (5 per cent). The present value (ie the fair value) of the asset is CU722 (CU758/1.05).

(b) Using Method 2, the expected cash flows are not adjusted for systematic (ie market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (ie the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (ie the fair value) of the asset is CU722 (CU780/1.08).

B30 When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

Applying present value techniques to liabilities and an entity's own equity instruments not held by other parties as assets (paragraphs 40 and 41)

B31 When using a present value technique to measure the fair value of a liability that is not held by another party as an asset (eg a decommissioning liability), an entity shall, among other things, estimate the future cash outflows that market participants would expect to incur in fulfilling the obligation. Those future cash outflows shall include market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation. Such compensation includes the return that a market participant would require for the following:

(a) undertaking the activity (ie the value of fulfilling the obligation; eg by using resources that could be used for other activities); and

(b) assuming the risk associated with the obligation (ie a *risk premium* that reflects the risk that the actual cash outflows might differ from the expected cash outflows; see paragraph B33).

B32 For example, a non-financial liability does not contain a contractual rate of return and there is no observable market yield for that liability. In some cases the components of the return that market participants would require will be indistinguishable from one another (eg when using the price a third party contractor would charge on a fixed fee basis). In other cases an entity needs to estimate those components separately (eg when using the price a third party contractor would charge on a cost plus basis because the contractor in that case would not bear the risk of future changes in costs).

B33 An entity can include a risk premium in the fair value measurement of a liability or an entity's own equity instrument that is not held by another party as an asset in one of the following ways:

(a) by adjusting the cash flows (ie as an increase in the amount of cash outflows); or

(b) by adjusting the rate used to discount the future cash flows to their present values (ie as a reduction in the discount rate).

An entity shall ensure that it does not double-count or omit adjustments for risk. For example, if the estimated cash flows are increased to take into account the compensation for assuming the risk associated with the obligation, the discount rate should not be adjusted to reflect that risk.

Inputs to valuation techniques (paragraphs 67–71)

B34 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include the following:

(a) *Exchange markets*. In an exchange market, closing prices are both readily available and generally representative of fair value. An example of such a market is the London Stock Exchange.

(b) *Dealer markets*. In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell, respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported) are dealer markets. Dealer markets also exist for some other assets and liabilities, including some financial instruments, commodities and physical assets (eg used equipment).

(c) *Brokered markets*. In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.

(d) *Principal-to-principal markets*. In a principal-to-principal market, transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

Fair value hierarchy (paragraphs 72–90)

Level 2 inputs (paragraphs 81–85)

B35 Examples of Level 2 inputs for particular assets and liabilities include the following:

(a) *Receive-fixed, pay-variable interest rate swap based on the London Interbank Offered Rate (LIBOR) swap rate*. A Level 2 input would be the LIBOR swap rate if that rate is observable at commonly quoted intervals for substantially the full term of the swap.

(b) *Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency*. A Level 2 input would be the swap rate based on a yield curve denominated in a foreign currency that is observable at commonly quoted intervals for substantially the full term of the swap. That would be the case if the term of the swap is 10 years and that rate is observable at commonly quoted intervals for 9 years, provided that any reasonable extrapolation of the yield curve for year 10 would not be significant to the fair value measurement of the swap in its entirety.

(c) *Receive-fixed, pay-variable interest rate swap based on a specific bank's prime rate*. A Level 2 input would be the bank's prime rate derived through extrapolation if the extrapolated values are corroborated by observable market data, for example, by correlation with an interest rate that is observable over substantially the full term of the swap.

(d) *Three-year option on exchange-traded shares*. A Level 2 input would be the implied volatility for the shares derived through extrapolation to year 3 if both of the following conditions exist:

(i) Prices for one-year and two-year options on the shares are observable.

(ii) The extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option.

In that case the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.

(e) *Licensing arrangement*. For a licensing arrangement that is acquired in a business combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate in the contract with the unrelated party at inception of the arrangement.

(f) *Finished goods inventory at a retail outlet*. For finished goods inventory that is acquired in a business combination, a Level 2 input would be either a price to customers in a retail market or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (ie similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.

(g) *Building held and used*. A Level 2 input would be the price per square metre for the building (a valuation multiple) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) buildings in similar locations.

(h) *Cash-generating unit*. A Level 2 input would be a valuation multiple (eg a multiple of earnings or revenue or a similar performance measure) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) businesses, taking into account operational, market, financial and non-financial factors.

Level 3 inputs (paragraphs 86–90)

B36 Examples of Level 3 inputs for particular assets and liabilities include the following:

(a) *Long-dated currency swap*. A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.

(b) *Three-year option on exchange-traded shares*. A Level 3 input would be historical volatility, ie the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.

(c) *Interest rate swap*. A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.

(d) *Decommissioning liability assumed in a business combination*. A Level 3 input would be a current estimate using the entity's own data about the future cash outflows to be paid to fulfil the obligation (including market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation to dismantle the asset) if there is no reasonably available information that indicates that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, eg a current risk-free interest rate or a credit-adjusted risk-free rate if the effect of the entity's credit standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows.

(e) *Cash-generating unit*. A Level 3 input would be a financial forecast (eg of cash flows or profit or loss) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

B37 The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). To determine whether, on the basis of the evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as the following:

(a) There are few recent transactions.

(b) Price quotations are not developed using current information.

(c) Price quotations vary substantially either over time or among market-makers (eg some brokered markets).

(d) Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.

(e) There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.

(f) There is a wide bid-ask spread or significant increase in the bid-ask spread.

(g) There is a significant decline in the activity of, or there is an absence of, a market for new issues (ie a primary market) for the asset or liability or similar assets or liabilities.

(h) Little information is publicly available (eg for transactions that take place in a principal-to-principal market).

B38 If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (eg there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (eg when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

B39 This HKFRS does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs 61–66 and B5–B11 for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B17). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions.

B40 If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (eg the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.

B41 Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (ie not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.

B42 Estimating the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires judgement. An entity's intention to hold the asset or to settle or otherwise fulfil the liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.

Identifying transactions that are not orderly

B43 The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances it is not appropriate to conclude that all transactions in that market are not orderly (ie forced liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

(a) There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.

(b) There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.

(c) The seller is in or near bankruptcy or receivership (ie the seller is distressed).

(d) The seller was required to sell to meet regulatory or legal requirements (ie the seller was forced).

(e) The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

An entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

B44 An entity shall consider all the following when measuring fair value or estimating market risk premiums:

(a) If the evidence indicates that a transaction is not orderly, an entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price.

(b) If the evidence indicates that a transaction is orderly, an entity shall take into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances, such as the following:

(i) the volume of the transaction.

(ii) the comparability of the transaction to the asset or liability being measured.

(iii) the proximity of the transaction to the measurement date.

(c) If an entity does not have sufficient information to conclude whether a transaction is orderly, it shall take into account the transaction price. However, that transaction price may not represent fair value (ie the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity shall place less weight on those transactions when compared with other transactions that are known to be orderly.

An entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When an entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

Using quoted prices provided by third parties

B45 This HKFRS does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, if an entity has determined that the quoted prices provided by those parties are developed in accordance with this HKFRS.

B46 If there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.

B47 Furthermore, the nature of a quote (eg whether the quote is an indicative price or a binding offer) shall be taken into account when weighting the available evidence, with more weight given to quotes provided by third parties that represent binding offers.

Appendix C
Effective date and transition

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

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

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

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

Appendix D
Amendments to other HKFRSs

This appendix sets out amendments to other HKFRSs that are a consequence of issuing HKFRS 13. An entity shall apply the amendments for annual periods beginning on or after 1 January 2013. If an entity applies HKFRS 13 for an earlier period, it shall apply the amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

Change in definition

D1 In HKFRSs 1, 3–5 and 9 (issued in November 2010) the definition of fair value is replaced with:

> *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13.)

In HKASs 2, 16, 18–21, 32 and 40 the definition of fair value is replaced with:

> *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

D2 Paragraph 19 is deleted.

D3 Paragraph 39J is added as follows:

39J HKFRS 13 *Fair Value Measurement*, issued in June 2011, deleted paragraph 19, amended the definition of fair value in Appendix A and amended paragraphs D15 and D20. An entity shall apply those amendments when it applies HKFRS 13.

D4 Paragraphs D15 and D20 are amended as follows:

D15 If a first-time adopter measures such an investment at cost in accordance with HKAS 27, it shall measure that investment at one of the following amounts in its separate opening HKFRS statement of financial position:

…

(b) deemed cost. The deemed cost of such an investment shall be its:

(i) fair value ~~(determined in accordance with HKAS 39)~~ at the entity's date of transition to HKFRSs in its separate financial statements; or

…

D20 Notwithstanding the requirements of paragraphs 7 and 9, an entity may apply the requirements in ~~the last sentence~~ paragraph AG76(a) of HKAS 39 ~~paragraph AG76 and in paragraph AG76A~~, in either of the following ways:

…

HKFRS 2 *Share-based Payment*

D5 Paragraph 6A is added as follows:

6A This HKFRS uses the term 'fair value' in a way that differs in some respects from the definition of fair value in HKFRS 13 *Fair Value Measurement*. Therefore, when applying HKFRS 2 an entity measures fair value in accordance with this HKFRS, not HKFRS 13.

HKFRS 3 *Business Combinations*

D6 Paragraphs 20, 29, 33 and 47 are amended as follows:

20 ~~Paragraphs B41–B45 provide guidance on measuring the fair value of particular identifiable assets and a non-controlling interest in an acquiree.~~ Paragraphs 24–31 specify the types of identifiable assets and liabilities that include items for which this HKFRS provides limited exceptions to the measurement principle.

29 The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract regardless of whether market participants would consider potential contractual renewals ~~in determining~~ when measuring its fair value. Paragraphs B35 and B36 provide related application guidance.

33 … To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquiree ~~determined using a valuation technique~~ in place of the acquisition-date fair value of the consideration transferred (paragraph 32(a)(i)). …

47 … For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value ~~determined~~ measured at that date is likely to indicate an error in the provisional amount.

D7 Paragraph 64F is added as follows:

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

D8 In Appendix B paragraphs B22 and B40, B43–B46, B49 and B64 are amended as follows:

B22 Because the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary except for its capital structure, the consolidated financial statements reflect:

…

(d) the amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree) ~~determined in accordance with this HKFRS~~. However, …

…

B40 The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in ~~estimating~~ measuring the fair value of an intangible asset. For example, the acquirer would take into account the assumptions that market participants would ~~consider~~ use when pricing the intangible asset, such as expectations of future contract renewals, in measuring fair value. …

B43 ~~For~~ To protect its competitive position, or for other reasons, the acquirer may intend not to use an acquired non-financial asset actively, ~~for example, a research and development intangible asset,~~ or it may not intend to use the asset ~~in a way that is different from the way in which other market participants would use it~~ according to its highest and best use. For example, that might be the case for an acquired research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer shall measure the fair value of the non-financial asset ~~at fair value determined in accordance with~~ assuming its highest and best use by ~~other~~ market participants in accordance with the appropriate valuation premise, both initially and when measuring fair value less costs of disposal for subsequent impairment testing.

B44 This HKFRS allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market ~~prices~~ for the equity shares (ie those not held by the acquirer). In other situations, however, a quoted price in an active market ~~price~~ for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using another valuation technique~~s~~.

B45 The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a ~~minority~~ non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

B46 In a business combination achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquiree for the acquisition-date fair value of the consideration transferred to measure goodwill or a gain on a bargain purchase (see paragraphs 32–34). ~~The acquirer should measure the acquisition-date fair value of its interest in the acquiree using one or more valuation techniques that are appropriate in the circumstances and for which sufficient data are available. If more than one valuation technique is used, the acquirer should evaluate the results of the techniques, considering the relevance and reliability of the inputs used and the extent of the available data.~~

B49 A fair value measurement of a mutual entity should include the assumptions that market participants would make about future member benefits as well as any other relevant assumptions market participants would make about the mutual entity. For example, ~~an estimated cash flow model~~ <u>a present value technique</u> may be used to ~~determine~~ <u>measure</u> the fair value of a mutual entity. The cash flows used as inputs to the model should be based on the expected cash flows of the mutual entity, which are likely to reflect reductions for member benefits, such as reduced fees charged for goods and services.

B64 To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

…

(f) the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

…

(iv) equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of ~~determining~~ <u>measuring</u> the fair value of those instruments or interests.

…

(o) for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:

…

(i) for each non-controlling interest in an acquiree measured at fair value, the valuation technique<u>(s)</u> and ~~key model~~ <u>significant</u> inputs used ~~for determining~~ <u>to measure</u> that value.

…

HKFRS 4 *Insurance Contracts*

D9 Paragraph 41E is added as follows:

41E HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended the definition of fair value in Appendix A. An entity shall apply that amendment when it applies HKFRS 13.

HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

D10 Paragraph 44H is added as follows:

44H HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended the definition of fair value in Appendix A. An entity shall apply that amendment when it applies HKFRS 13.

HKFRS 7 *Financial Instruments: Disclosures*

D11 Paragraph IN5C is added as follows:

IN5C In June 2011 the HKICPA relocated the disclosures about fair value measurements to HKFRS 13 *Fair Value Measurement*.

D12 Paragraph 3 is amended as follows:

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) ... in those cases, entities shall apply the requirements of this HKFRS <u>and, for those interests measured at fair value, the requirements of HKFRS 13 *Fair Value Measurement*</u>. ...

…

D13 Paragraphs 27–27B are deleted.

D14 Paragraph 28 is amended as follows:

28 ~~If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG74–AG79 of HKAS 39). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless conditions described in paragraph AG76 of HKAS 39 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:~~ <u>In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph AG76 of HKAS 39). In such cases, the entity shall disclose by class of financial asset or financial liability:</u>

(a) its accounting policy for recognising <u>in profit or loss the</u> ~~that~~ difference <u>between the fair value at initial recognition and the transaction price</u> ~~in profit or loss~~ to reflect a change in factors (including time) that market participants would ~~consider in setting a price~~ <u>take into account when pricing the asset or liability</u> (see paragraph ~~AG76A~~ <u>AG76(b)</u> of HKAS 39)<u>.</u> ~~; and~~

…

(c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

D15 Paragraph 29 is amended as follows:

29 Disclosures of fair value are not required:

…

(b) for an investment in equity instruments that do not have a quoted ~~market~~ price in an active market for an identical instrument (ie a Level 1 input), or derivatives linked to such equity instruments, that is measured at cost in accordance with HKAS 39 because its fair value cannot otherwise be measured reliably; or

…

D16 Paragraph 44P is added as follows:

44P HKFRS 13, issued in June 2011, amended paragraphs 3, 28, 29, B4 and B26 and Appendix A and deleted paragraphs 27–27B. An entity shall apply those amendments when it applies HKFRS 13.

D17 In Appendix A the definition of other price risk is amended as follows:

other price risk The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from **interest rate risk** or **currency risk**), whether those changes are caused by factors specific to the individual financial instrument or its issuer~~,~~ or by factors affecting all similar financial instruments traded in the market.

HKFRS 9 *Financial Instruments* (issued November 2009)

D18 Paragraph 5.1.1 is amended as follows:

5.1.1 At initial recognition, an entity shall measure a financial asset at its fair value ~~(see paragraphs 48, 48A and AG69–AG82 of HKAS 39)~~ plus, in the case of a financial asset not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition of the financial asset.

D19 Paragraph 5.1.1A is added as follows:

5.1.1A However, if the fair value of the financial asset at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1 and paragraph AG76 of HKAS 39.

D20 Paragraphs 5.2.1, 5.3.2, 8.2.5 and 8.2.11 are amended as follows:

5.2.1 After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1–4.5 at fair value ~~(see paragraphs 48, 48A and AG69–AG82 of HKAS 39)~~ or amortised cost.

5.3.2 If, in accordance with paragraph 4.9, an entity reclassifies a financial asset so that it is measured at fair value, its fair value is ~~determined~~ measured at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss.

8.2.5 If an entity measures a hybrid contract at fair value in accordance with paragraph 4.4 or paragraph 4.5 but the fair value of the hybrid contract had not been ~~determined~~ measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (ie the non-derivative host and the embedded derivative) at the end of each comparative reporting period.

8.2.11 If an entity previously accounted for an investment in an ~~unquoted~~ equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input) (or a derivative that is linked to and must be settled by delivery of such an ~~unquoted~~ equity instrument) at cost in accordance with HKAS 39, it shall measure that instrument at fair value at the date of initial application. ...

D21 Paragraph 8.1.3 is added as follows:

8.1.3 HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended paragraphs 5.1.1, 5.2.1, 5.3.2, 8.2.5, 8.2.11, B5.1, B5.4, B5.5, B5.7, C8, C20, C22, C27 and C28 and added paragraph 5.1.1A. An entity shall apply those amendments when it applies HKFRS 13.

D22 In Appendix A the introductory text is amended as follows:

The following terms are defined in paragraph 11 of HKAS 32 *Financial Instruments: Presentation*, ~~or~~ paragraph 9 of HKAS 39 or Appendix A of HKFRS 13 and are used in this HKFRS with the meanings specified in HKAS 32, ~~or~~ HKAS 39 or HKFRS 13: ...

D23 In Appendix B paragraph B5.1, the heading above paragraph B5.5 and paragraphs B5.5 and B5.7 are amended as follows:

B5.1 The fair value of a financial asset at initial recognition is normally the transaction price (ie the fair value of the consideration given, see also HKFRS 13 and paragraph AG76 of HKAS 39). However, if part of the consideration given is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument ~~is estimated using a valuation technique (see paragraphs AG74–AG79 of HKAS 39)~~. For example, the fair value of a long-term loan or receivable that carries no interest can be ~~estimated~~ measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

Investments in ~~unquoted~~ equity instruments ~~(~~and contracts on those investments ~~that must be settled by delivery of the unquoted equity instruments)~~

B5.5 ... That may be the case if insufficient more recent information is available to ~~determine~~ <u>measure</u> fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

B5.7 ... In such cases, the entity must ~~estimate~~ <u>measure</u> fair value.

D24 In Appendix C, in paragraph C8 the amendments to paragraph 29 of HKFRS 7 *Financial Instruments: Disclosures* are amended as follows:

29 Disclosures of fair value are not required:

…

(b) for derivatives linked to investments in equity instruments that do not have a quoted ~~market~~ price in an active market <u>for an identical instrument (ie a Level 1 input)</u> that are measured at cost in accordance with HKAS 39 because their fair value cannot <u>otherwise</u> be measured reliably; or

…

D25 In paragraph C20 the amendments to paragraph 1 of HKAS 28 *Investments in Associates* are amended as follows:

1 This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. ~~An entity shall measure such investments at fair value through profit or loss in accordance with HKFRS 9.~~ An entity holding such an investment shall make the disclosures required by paragraph 37(f).

D26 In paragraph C22 the amendments to paragraph 1 of HKAS 31 *Interests in Joint Ventures* are amended as follows:

1 This Standard shall 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. However, it does not apply to venturers' interests in jointly controlled entities held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. ~~An entity shall measure such investments at fair value through profit or loss in accordance with HKFRS 9.~~ A venturer holding such an interest shall make the disclosures required by paragraphs 55 and 56.

D27 In paragraph C27 the amendments to paragraphs 9, 13 and 88 of HKAS 39 *Financial Instruments: Recognition and Measurement* are amended as follows:

9 ...

It should be noted that <u>HKFRS 13 *Fair Value Measurement*</u> ~~paragraphs 48, 48A, 49 and Appendix A paragraphs AG69–AG82, which~~ set<u>s</u> out <u>the</u> requirements for ~~determining a reliable measure of~~ <u>measuring</u> the fair value of a financial liability, ~~apply equally to all items that are measured at fair value,~~ whether by designation or otherwise, or whose fair value is disclosed.

...

13 If an entity is unable to ~~determine~~ <u>measure</u> reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) contract and the fair value of the host ~~if those can be determined under this Standard~~. If the entity is unable to ~~determine~~ <u>measure</u> the fair value of the embedded derivative using this method, paragraph 12 applies and the hybrid (combined) contract is designated as at fair value through profit or loss.

88 A hedging relationship qualifies for hedge accounting under paragraphs 89–102 if, and only if, all ~~of~~ the following conditions are met.

...

(d) The effectiveness of the hedge can be reliably measured, ie the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured ~~(see paragraph 47(a) and Appendix A paragraphs AG80 and AG81 for guidance on determining fair value)~~.

…

D28 In paragraph C28 the amendments to paragraphs AG64, AG80, AG81 and AG96 of HKAS 39 are amended as follows:

AG64 The fair value of a financial liability on initial recognition is normally the transaction price (ie the fair value of the consideration received, see also paragraph AG76 <u>and HKFRS 13</u>). However, if part of the consideration given or received is for something other than the financial liability, <u>an entity shall measure</u> the fair value of the financial liability ~~is estimated, using a valuation technique (see paragraphs AG74–AG79)~~.

AG 80 The fair value of derivatives that are linked to and must be settled by delivery of ~~unquoted~~ equity instruments that do not have a quoted price in an active market for an identical instrument (ie a Level 1 input) (see paragraph 47(a)) is reliably measurable if (a) the variability in the range of reasonable fair value ~~estimates~~ measurements is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used ~~in estimating~~ when measuring fair value.

AG81 There are many situations in which the variability in the range of reasonable fair value ~~estimates~~ measurements of derivatives that are linked to and must be settled by delivery of ~~unquoted~~ equity instruments that do not have a quoted price in an active market for an identical instrument (ie a Level 1 input) (see paragraph 47(a)) is likely not to be significant. Normally it is possible to ~~estimate~~ measure the fair value of such derivatives that an entity has acquired from an outside party. However, if the range of reasonable fair value ~~estimates~~ measurements is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

AG96 A derivative that is linked to and must be settled by delivery of ~~unquoted~~ equity instruments that do not have a quoted price in an active market for an identical instrument (ie a Level 1 input) and is not carried at fair value because its fair value cannot otherwise be reliably measured (see paragraph 47(a)) cannot be designated as a hedging instrument.

HKFRS 9 *Financial Instruments* (issued November 2010)

D29 Paragraph IN7 is amended as follows:

IN 7 In November 2010 the HKICPA added to HKFRS 9 the requirements for classification and measurement of financial liabilities:

…

(b) Consistently with the requirements in HKFRS 9 for investments in ~~unquoted~~ equity instruments that do not have a quoted price in an active market for an identical instrument (ie a Level 1 input) (and derivative assets linked to those investments), the exception from fair value measurement was eliminated for derivative liabilities that are linked to and must be settled by delivery of such an ~~unquoted~~ equity instrument. Under HKAS 39, if those derivatives were not reliably measurable, they were required to be measured at cost. HKFRS 9 requires them to be measured at fair value.

…

D30 Paragraphs 3.2.14, 4.3.7 and 5.1.1 are amended as follows:

3.2.14 When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognised and the part that is derecognised, the fair value of the part that continues to be recognised needs to be ~~determined~~ measured. When the entity has a history of selling parts similar to the part that continues to be recognised or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. …

4.3.7 If an entity is unable to ~~determine~~ measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host~~, if those can be determined under this HKFRS~~. If the entity is unable to ~~determine~~ measure the fair value of the embedded derivative using this method, paragraph 4.3.6 applies and the hybrid contract is designated as at fair value through profit or loss.

5.1.1 At initial recognition, an entity shall measure a financial asset or financial liability at its fair value ~~(see paragraphs 5.4.1–5.4.3 and B5.4.1–B5.4.17)~~ plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability.

D31 Paragraph 5.1.1A is added as follows:

5.1.1A However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1.2A.

D32 Paragraph 5.2.1 is amended as follows:

5.2.1 After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1.1–4.1.5 at fair value ~~(see paragraphs 5.4.1, 5.4.2 and B5.4.1–B5.4.17)~~ or amortised cost (see paragraphs 9 and AG5–AG8 of HKAS 39).

D33 The heading above paragraph 5.4.1 and paragraphs 5.4.1–5.4.3 are deleted.

D34 Paragraphs 5.6.2, 7.2.5, 7.2.11 and 7.2.12 are amended as follows:

5.6.2 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset so that it is measured at fair value, its fair value is ~~determined~~ measured at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss.

7.2.5 If an entity measures a hybrid contract at fair value in accordance with paragraph 4.1.4 or paragraph 4.1.5 but the fair value of the hybrid contract had not been ~~determined~~ measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (ie the non-derivative host and the embedded derivative) at the end of each comparative reporting period.

7.2.11 If an entity previously accounted for an investment in an ~~unquoted~~ equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input) (or a derivative asset that is linked to and must be settled by delivery of such an ~~unquoted~~ equity instrument) at cost in accordance with HKAS 39, it shall measure that instrument at fair value at the date of initial application. ...

7.2.12 If an entity previously accounted for a derivative liability that is linked to and must be settled by delivery of an ~~unquoted~~ equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input) at cost in accordance with HKAS 39, it shall measure that derivative liability at fair value at the date of initial application. ...

D35 Paragraph 7.1.3 is added as follows:

7.1.3 HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended paragraphs 3.2.14, 4.3.7, 5.1.1, 5.2.1, 5.4.1, 5.6.2, 7.2.5, 7.2.11, 7.2.12, amended the definition of fair value in Appendix A, amended paragraphs B3.2.11, B3.2.17, B5.1.1, B5.2.2, B5.4.8, B5.4.14, B5.4.16, B5.7.20, C3, C11, C26, C28, C30, C49 and C53, deleted paragraphs 5.4.2, B5.4.1–B5.4.13 and added paragraphs 5.1.1A, B5.1.2A and B5.2.2A. An entity shall apply those amendments when it applies HKFRS 13.

D36 In Appendix B paragraphs B3.2.11, B3.2.17, B5.1.1 and B5.2.2 are amended as follows:

B3.2.11 ~~In estimating~~ When measuring the fair values of the part that continues to be recognised and the part that is derecognised for the purposes of applying paragraph 3.2.13, an entity applies the fair value measurement requirements in ~~paragraphs 5.4.1–5.4.3 and B5.4.1–B5.4.13~~ HKFRS 13 in addition to paragraph 3.2.14.

B3.2.17 This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans … The fair value of the loans at the date of the transaction is CU10,100 and the ~~estimated~~ fair value of the excess spread of 0.5 per cent is CU40.

…

The entity calculates the gain or loss on the sale of the 90 per cent share of cash flows. Assuming that separate fair values of the 90 per cent part transferred and the 10 per cent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 3.2.14 as follows:

	~~Estimated fair~~ Fair value	*Percentage*	*Allocated carrying amount*
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
Total	**10,100**		**10,000**

…

B5.1.1 The fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph ~~B5.4.8~~ B5.1.2A and HKFRS 13). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument ~~is estimated using a valuation technique (see paragraphs B5.4.6–B5.4.12)~~. For example, the fair value of a long-term loan or receivable that carries no interest can be ~~estimated~~ measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

D37 Paragraphs B5.1.2A and B5.2.2A are added as follows:

B5.1.2A The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also HKFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:

(a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

B5.2.2A The subsequent measurement of a financial asset or financial liability and the subsequent recognition of gains and losses described in paragraph B5.1.2A shall be consistent with the requirements of this HKFRS.

D38 Paragraphs B5.4.1–B5.4.13 and their related headings are deleted.

D39 The heading above paragraph B5.4.14 and paragraphs B5.4.14, B5.4.16 and B5.7.20 are amended as follows:

Investments in ~~unquoted~~ equity instruments ~~(~~and contracts on those investments ~~that must be settled by delivery of the unquoted equity instruments)~~

B5.4.14 ... That may be the case if insufficient more recent information is available to ~~determine~~ measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

B5.4.16 ... To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must ~~estimate~~ measure fair value.

B5.7.20 As with all ~~estimates of~~ fair value measurements, an entity's measurement method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of ~~market~~ relevant observable inputs and minimum use of unobservable inputs.

D40 In Appendix C, in paragraph C3 the amendments to paragraphs D15 and D20 of HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* are amended as follows:

D15 If a first-time adopter measures such an investment at cost in accordance with HKAS 27, it shall measure that investment at one of the following amounts in its separate opening HKFRS statement of financial position:

…

(b) deemed cost. The deemed cost of such an investment shall be its:

(i) fair value ~~(determined in accordance with HKFRS 9)~~ at the entity's date of transition to HKFRSs in its separate financial statements; or

…

D20 Despite the requirements of paragraphs 7 and 9, an entity may apply the requirements in ~~the last sentence of~~ paragraph ~~B5.4.8 and in paragraph B5.4.9~~ B5.1.2A(b) of HKFRS 9, in either of the following ways:

…

D41 In paragraph C11 the amendments to paragraph 28 of HKFRS 7 *Financial Instruments: Disclosures* are amended as follows:

28 ~~If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs B5.4.6–B5.4.12 of HKFRS 9). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless the conditions described in paragraph B5.4.8 of HKFRS 9 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:~~ In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph B5.1.2A of HKFRS 9). In such cases, the entity shall disclose by class of financial asset or financial liability:

(a) its accounting policy for recognising in profit or loss the ~~that~~ difference between the fair value at initial recognition and the transaction price ~~in profit or loss~~ to reflect a change in factors (including time) that market participants would ~~consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~B5.4.9~~ B5.1.2A(b) of HKFRS 9). ~~; and~~

…

(c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

D42 In paragraph C26 the amendments to paragraph 1 of HKAS 28 *Investments in Associates* are amended as follows:

1 This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments*. ~~An entity shall measure such investments at fair value through profit or loss in accordance with HKFRS 9.~~ An entity holding such an investment shall make the disclosures required by paragraph 37(f).

D43 In paragraph C28 the amendments to paragraph 1 of HKAS 31 *Interests in Joint Ventures* are amended as follows:

1 This Standard shall 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. However, it does not apply to venturers' interests in jointly controlled entities held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments*. ~~An entity shall measure such investments at fair value through profit or loss in accordance with HKFRS 9.~~ A venturer holding such an interest shall make the disclosures required by paragraphs 55 and 56.

D44 In paragraph C30 the amendments to paragraph 23 of HKAS 32 *Financial Instruments: Presentation* are amended as follows:

23 … One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. ~~When the~~ The financial liability is recognised initially at ~~under HKFRS 9, its fair value (~~the present value of the redemption amount~~)~~, and is reclassified from equity. …

D45 In paragraph C49 the amendments to paragraph A8 of HK(IFRIC)-Int 2 *Members' Shares in Co-operative Entities and Similar Instruments* are amended as follows:

A8 Members' shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity ~~determines~~ measures the fair value of such financial liabilities in accordance with paragraph 47 of HKFRS 13 ~~as required by paragraph 5.4.3 of HKFRS 9~~, which states: 'The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand …' Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

D46 In paragraph C53 the amendments to paragraph 7 of HK(IFRIC)-Int 19 *Extinguishing Financial Liabilities with Equity Instruments* are amended as follows:

7 If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph ~~5.4.3~~ <u>47</u> of ~~HKFRS 9~~ <u>HKFRS 13</u> is not applied.

HKAS 1 *Presentation of Financial Statements*

D47 Paragraphs 128 and 133 are amended as follows:

128 The disclosures in paragraph 125 are not required for assets and liabilities with a significant risk that their carrying amounts might change materially within the next financial year if, at the end of the reporting period, they are measured at fair value based on ~~recently observed market prices~~ <u>a quoted price in an active market for an identical asset or liability</u>. Such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.

133 Other HKFRSs require the disclosure of some of the assumptions that would otherwise be required in accordance with paragraph 125. For example, HKAS 37 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. ~~HKFRS 7~~ <u>HKFRS 13 *Fair Value Measurement*</u> requires disclosure of significant assumptions<u> (including the valuation technique(s) and inputs)</u> the entity uses <u>when measuring</u> ~~in estimating~~ the fair values of ~~financial~~ assets and ~~financial~~ liabilities that are carried at fair value. ~~HKAS 16 requires disclosure of significant assumptions that the entity uses in estimating the fair values of revalued items of property, plant and equipment.~~

D48 Paragraph 139I is added as follows:

139I HKFRS 13, issued in June 2011, amended paragraphs 128 and 133. An entity shall apply those amendments when it applies HKFRS 13.

HKAS 2 *Inventories*

D49 Paragraph 7 is amended as follows:

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

D50 Paragraph 40C is added as follows:

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

HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

D51 Paragraph 52 is amended as follows:

52 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

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

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

D52 Paragraph 54C is added as follows:

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

HKAS 10 *Events after the Reporting Period*

D53 Paragraph 11 is amended as follows:

11 An example of a non-adjusting event after the reporting period is a decline in ~~market~~ fair value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in ~~market~~ fair value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. …

D54 Paragraph 23A is added as follows:

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

HKAS 16 *Property, Plant and Equipment*

D55 Paragraph 26 is amended as follows:

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

D56 Paragraphs 32 and 33 are deleted.

D57 Paragraphs 35 and 77 are amended as follows:

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

(a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount.

This method is often used when an asset is revalued by means of applying an index to determine its ~~depreciated~~ replacement cost (see HKFRS 13).

…

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

…

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

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

…

D58 Paragraph 81F is added as follows:

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

HKAS 17 *Leases*

D59 Paragraph 6A is added as follows:

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

HKAS 18 *Revenue*

D60 In the rubric 'paragraphs 1–41' is amended to 'paragraphs 1–42'.

Paragraph 42 is added as follows:

42 HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 7. An entity shall apply that amendment when it applies HKFRS 13.

HKAS 19 *Employee Benefits*

D61 In the rubric, 'paragraphs 1–161' is amended to 'paragraphs 1–162'.

D62 Paragraphs 50 and 102 are amended as follows:

50 Accounting by an entity for defined benefit plans involves the following steps:

…

(c) ~~determining~~ measuring the fair value of any plan assets (see paragraphs 102–104);

…

102 The fair value of any plan assets is deducted in determining the amount recognised in the statement of financial position in accordance with ~~under~~ paragraph 54. ~~When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).~~

D63 Paragraph 162 is added as follows:

162 HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 7 and amended paragraphs 50 and 102. An entity shall apply those amendments when it applies HKFRS 13.

HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

D64 In the rubric 'paragraphs 1–44' is amended to 'paragraphs 1–45'.

Paragraph 45 is added as follows:

45 HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 3. An entity shall apply that amendment when it applies HKFRS 13.

HKAS 21 *The Effects of Changes in Foreign Exchange Rates*

D65 Paragraph 23 is amended as follows:

23 At the end of each reporting period:

…

(c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was ~~determined~~ <u>measured</u>.

D66 Paragraph 60G is added as follows:

60G HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 8 and amended paragraph 23. An entity shall apply those amendments when it applies HKFRS 13.

HKAS 28 *Investments in Associates*

D67 Paragraphs 1 and 37 are amended as follows:

1 This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*. <u>For such</u> ~~Such~~ investments ~~shall be measured at fair value in accordance with HKAS 39~~, <u>an entity shall recognise</u> ~~with~~ changes in fair value ~~recognised~~ in profit or loss in the period of the change. An entity holding such an investment shall make the disclosures required by paragraph 37(f).

37 The following disclosures shall be made:

(a) the fair value of investments in associates for which there are ~~published price quotations~~ quoted market prices;

…

D68 Paragraph 41G is added as follows:

41G HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended paragraphs 1 and 37. An entity shall apply those amendments when it applies HKFRS 13.

HKAS 31 *Interests in Joint Ventures*

D69 Paragraph 1 is amended as follows:

1 This Standard shall 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. However, it does not apply to venturers' interests in jointly controlled entities held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*. For such ~~Such~~ investments ~~shall be measured at fair value in accordance with HKAS 39~~, an entity shall recognise ~~with~~ changes in fair value ~~recognised~~ in profit or loss in the period of the change. A venturer holding such an interest shall make the disclosures required by paragraphs 55 and 56.

D70 Paragraph 58F is added as follows:

58F HKFRS 13 *Fair Value Measurement*, issued in June 2011, amended paragraph 1. An entity shall apply that amendment when it applies HKFRS 13.

HKAS 32 *Financial Instruments: Presentation*

D71 Paragraph 23 is amended as follows:

23 … ~~When the~~ The financial liability is recognised initially ~~under HKAS 39, its fair value (~~at the present value of the redemption amount~~)~~, and is reclassified from equity. …

D72 Paragraph 97J is added as follows:

97J HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 11 and amended paragraphs 23 and AG31. An entity shall apply those amendments when it applies HKFRS 13.

D73 In the Application Guidance paragraph AG31 is amended as follows:

AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the statement of financial position, as follows:

…

(b) The equity instrument is an embedded option to convert the liability into equity of the issuer. ~~The fair value of the option comprises its time value and its intrinsic value, if any.~~ This option has value on initial recognition even when it is out of the money.

HKAS 33 *Earnings per Share*

D74 Paragraphs 8 and 47A are amended as follows:

8 Terms defined in HKAS 32 *Financial Instruments: Presentation* are used in this Standard with the meanings specified in paragraph 11 of HKAS 32, unless otherwise noted. HKAS 32 defines financial instrument, financial asset, financial liability~~,~~ and equity instrument ~~and fair value~~, and provides guidance on applying those definitions. HKFRS 13 *Fair Value Measurement* defines fair value and sets out requirements for applying that definition.

47A For share options and other share-based payment arrangements to which HKFRS 2 *Share-based Payment* applies, the issue price referred to in paragraph 46 and the exercise price referred to in paragraph 47 shall include the fair value (measured in accordance with HKFRS 2) of any goods or services to be supplied to the entity in the future under the share option or other share-based payment arrangement.

D75 Paragraph 74C is added as follows:

74C HKFRS 13, issued in June 2011, amended paragraphs 8, 47A and A2. An entity shall apply those amendments when it applies HKFRS 13.

D76 In Appendix A paragraph A2 is amended as follows:

A2 The issue of ordinary shares at the time of exercise or conversion of potential ordinary shares does not usually give rise to a bonus element. This is because the potential ordinary shares are usually issued for ~~full~~ fair value, resulting in a proportionate change in the resources available to the entity. In a rights issue, however, the exercise price is often less than the fair value of the shares. … The theoretical ex-rights fair value per share is calculated by adding the aggregate ~~market~~ fair value of the shares immediately before the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights.

Where the rights are to be publicly traded separately from the shares before the exercise date, fair value ~~for the purposes of this calculation~~ is ~~established~~ measured at the close of the last day on which the shares are traded together with the rights.

HKAS 34 *Interim Financial Reporting*

D77 In the rubric 'paragraphs 1–49' is amended to 'paragraphs 1–50'.

D78 Paragraph 16A(j) is added as follows:

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

…

(j) for financial instruments, the disclosures about fair value required by paragraphs 91–93(h), 94–96, 98 and 99 of HKFRS 13 *Fair Value Measurement* and paragraphs 25, 26 and 28–30 of HKFRS 7 *Financial Instruments: Disclosures*.

D79 Paragraph 50 is added as follows:

50 HKFRS 13, issued in June 2011, added paragraph 16A(j). An entity shall apply that amendment when it applies HKFRS 13.

HKAS 36 *Impairment of Assets*

D80 Paragraph 5 is amended as follows:

5 This Standard does not apply to financial assets within the scope of HKAS 39, investment property measured at fair value ~~in accordance with~~ within the scope of HKAS 40, or biological assets related to agricultural activity measured at fair value less costs to sell ~~in accordance with~~ within the scope of HKAS 41. However, this Standard applies to assets that are carried at revalued amount (ie fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses) in accordance with other HKFRSs, such as the revaluation models in HKAS 16 *Property, Plant and Equipment* and HKAS 38 *Intangible Assets*. The only difference between an asset's fair value and its fair value less costs of disposal is the direct incremental costs attributable to the disposal of the asset. ~~Identifying whether a revalued asset may be impaired depends on the basis used to determine fair value:~~

(a) ~~if the asset's fair value is its market value, the only difference between the asset's fair value and its fair value less costs to sell is the direct incremental costs to dispose of the asset:~~

~~(i)~~ ~~if~~ If the disposal costs are negligible, the recoverable amount of the revalued asset is necessarily close to, or greater than, its revalued amount ~~(ie fair value)~~. In this case, after the revaluation requirements have been applied, it is unlikely that the revalued asset is impaired and recoverable amount need not be estimated.

~~(ii) if the disposal costs are not negligible, the fair value less costs to sell of the revalued asset is necessarily less than its fair value. Therefore, the revalued asset will be impaired if its value in use is less than its revalued amount (ie fair value). In this case, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.~~

(b) [deleted] ~~if the asset's fair value is determined on a basis other than its market value, its revalued amount (ie fair value) may be greater or lower than its recoverable amount. Hence, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.~~

(c) If the disposal costs are not negligible, the fair value less costs of disposal of the revalued asset is necessarily less than its fair value. Therefore, the revalued asset will be impaired if its value in use is less than its revalued amount. In this case, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.

D81 Paragraph 6 is amended as follows (as a consequence of the amendment to the definition of fair value less costs to sell, all references to 'fair value less costs to sell' in HKAS 36 are replaced with 'fair value less costs of disposal'):

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

~~**An *active market* is a market where all the following conditions exist:**~~

(a) ~~**the items traded within the market are homogeneous;**~~

(b) ~~**willing buyers and sellers can normally be found at any time; and**~~

(c) ~~**prices are available to the public.**~~

Fair value ~~***less costs to sell***~~ ~~**is the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal**~~ **is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)**

D82 Paragraphs 12, 20 and 22 are amended as follows:

12 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) **~~during the period,~~ <u>there are observable indications that the</u> ~~an~~ asset's ~~market~~ value has declined <u>during the period</u> significantly more than would be expected as a result of the passage of time or normal use.**

…

20 It may be possible to ~~determine~~ <u>measure</u> fair value less costs ~~to sell~~ <u>of disposal</u>, even if <u>there is not a quoted price in an active market for</u> an <u>identical</u> asset ~~is not traded in an active market~~. However, sometimes it will not be possible to ~~determine~~ <u>measure</u> fair value less costs ~~to sell~~ <u>of disposal</u> because there is no basis for making a reliable estimate of the ~~amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties~~ <u>price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions</u>. In this case, the entity may use the asset's value in use as its recoverable amount.

22 Recoverable amount is determined for an individual asset … unless either:

…

(b) the asset's value in use can be estimated to be close to its fair value less costs ~~to sell~~ <u>of disposal</u> and fair value less costs ~~to sell~~ <u>of disposal</u> can be ~~determined~~ <u>measured</u>.

D83 Paragraphs 25–27 are deleted.

D84 Paragraph 28 is amended as follows:

28 Costs of disposal, other than those that have been recognised as liabilities, are deducted in ~~determining~~ <u>measuring</u> fair value less costs ~~to sell~~ <u>of disposal</u>. Examples …

D85 Paragraph 53A is added as follows:

53A Fair value differs from value in use. Fair value reflects the assumptions market participants would use when pricing the asset. In contrast, value in use reflects the effects of factors that may be specific to the entity and not applicable to entities in general. For example, fair value does not reflect any of the following factors to the extent that they would not be generally available to market participants:

(a) additional value derived from the grouping of assets (such as the creation of a portfolio of investment properties in different locations);

(b) synergies between the asset being measured and other assets;

(c) legal rights or legal restrictions that are specific only to the current owner of the asset; and

(d) tax benefits or tax burdens that are specific to the current owner of the asset.

D86 Paragraphs 78, 105, 111, 130 and 134 are amended as follows:

78 It may be necessary to consider some recognised liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability. In this case, the fair value less costs ~~to sell~~ of disposal (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the ~~estimated selling~~ price to sell ~~for~~ the assets of the cash-generating unit and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

105 In allocating an impairment loss in accordance with paragraph 104, an entity shall not reduce the carrying amount of an asset below the highest of:

(a) its fair value less costs ~~to sell~~ of disposal (if ~~determinable~~ measurable);

…

111 In assessing whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) there are observable indications that the asset's ~~market~~ value has increased significantly during the period.

…

130 An entity shall disclose the following for each material impairment loss recognised or reversed during the period for an individual asset, including goodwill, or a cash-generating unit:

…

(f) if recoverable amount is fair value less costs ~~to sell~~ of disposal, the basis used to ~~determine~~ measure fair value less costs ~~to sell~~ of disposal (such as whether fair value was ~~determined~~ measured by reference to a quoted price in an active market for an identical asset). An entity is not required to provide the disclosures required by HKFRS 13.

134 An entity shall disclose the information required by (a)–(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:

…

(c) the recoverable amount of the unit (or group of units) and the basis on which the unit's (group of units') recoverable amount has been determined (ie value in use or fair value less costs ~~to sell~~ of disposal).

(d) if the unit's (group of units') recoverable amount is based on value in use:

(i) ~~a description of~~ each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.

…

(e) if the unit's (group of units') recoverable amount is based on fair value less costs ~~to sell~~ of disposal, the ~~methodology~~ valuation technique(s) used to ~~determine~~ measure fair value less costs ~~to sell~~ of disposal. An entity is not required to provide the disclosures required by HKFRS 13. If fair value less costs ~~to sell~~ of disposal is not ~~determined~~ measured using ~~an observable market~~ a quoted price for ~~the~~ an identical unit (group of units), an entity shall disclose the following information ~~shall also be disclosed~~:

(i) ~~a description of~~ each key assumption on which management has based its determination of fair value less costs ~~to sell~~ of disposal. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.

…

(iiA) the level of the fair value hierarchy (see HKFRS 13) within which the fair value measurement is categorised in its entirety (without giving regard to the observability of 'costs of disposal').

(iiB) if there has been a change in valuation technique, the change and the reason(s) for making it.

If fair value less costs ~~to sell~~ of disposal is ~~determined~~ measured using discounted cash flow projections, an entity shall disclose the following information ~~shall also be disclosed~~:

(iii) the period over which management has projected cash flows.

(iv) the growth rate used to extrapolate cash flow projections.

(v) the discount rate(s) applied to the cash flow projections.

…

D87 Paragraph 140I is added as follows:

140I HKFRS 13, issued in June 2011, amended paragraphs 5, 6, 12, 20, 78, 105, 111, 130 and 134, deleted paragraphs 25–27 and added paragraphs 25A and 53A. An entity shall apply those amendments when it applies HKFRS 13.

HKAS 38 *Intangible Assets*

D88 Paragraph 8 is amended as follows:

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

~~An *active market* is a market in which all the following conditions exist:~~

(a) ~~the items traded in the market are homogeneous;~~

(b) ~~willing buyers and sellers can normally be found at any time; and~~

(c) ~~prices are available to the public.~~

...

***Fair value* ~~*of an asset* is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction~~ <u>is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date</u>. <u>(See HKFRS 13 *Fair Value Measurement*.)</u>**

D89 Paragraph 33 is amended as follows:

33 In accordance with HKFRS 3 *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect <u>market participants'</u> expectations <u>at the acquisition date</u> about the probability that the expected future economic benefits embodied in the asset will flow to the entity. …

D90 The heading above paragraph 35 is amended as follows:

~~Measuring the fair value of an i~~ <u>I</u>ntangible asset acquired in a business combination

D91 Paragraphs 39–41 are deleted.

D92 Paragraphs 47, 50, 75, 78, 82, 84 and 100 are amended as follows:

47 Paragraph 21(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset ~~for which comparable market transactions do not exist~~ is reliably measurable if (a) the variability in the range of reasonable fair value ~~estimates~~ <u>measurements</u> is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used ~~in estimating~~ <u>when measuring</u> fair value. If an entity is able to ~~determine~~ <u>measure</u> reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

50 Differences between the ~~market~~ <u>fair</u> value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the <u>fair</u> value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

75 … For the purpose of revaluations under this Standard, fair value shall be ~~determined~~ <u>measured</u> by reference to an active market. …

78 It is uncommon for an active market ~~with the characteristics described in paragraph 8~~ to exist for an intangible asset, although this may happen. …

82 If the fair value of a revalued intangible asset can no longer be ~~determined~~ <u>measured</u> by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

84 If the fair value of the asset can be ~~determined~~ <u>measured</u> by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

100 The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:

…

(b) there is an active market <u>(as defined in HKFRS 13)</u> for the asset and:

…

D93 Paragraph 124 is amended as follows:

124 If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:

(a) by class of intangible assets:

…

(iii) the carrying amount … paragraph 74; <u>and</u>

(b) the amount of … shareholders~~; and~~ <u>.</u>

(c) <u>[deleted]</u> **~~the methods and significant assumptions applied in estimating the assets' fair values.~~**

D94 Paragraph 130E is deleted.

D95 Paragraph 130G is added as follows:

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

HKAS 39 *Financial Instruments: Recognition and Measurement*

D96 The heading above paragraph IN18 and paragraphs IN18 and IN19 are deleted.

D97 Paragraph 9 is amended as follows:

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

…

It should be noted that <u>HKFRS 13 *Fair Value Measurement*</u> ~~paragraphs 48, 48A, 49 and Appendix A paragraphs AG69–AG82, which~~ set<u>s</u> out <u>the</u> requirements for ~~determining a reliable measure of~~ <u>measuring</u> the fair value of a financial asset or financial liability, ~~apply equally to all items that are measured at fair value,~~ whether by designation or otherwise, or whose fair value is disclosed.

...

***Fair value* is the ~~amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.*~~ <u>price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13.)</u>**

...

The footnote to the definition of fair value is deleted.

D98 Paragraphs 13 and 28 are amended as follows:

13 If an entity is unable to ~~determine~~ <u>measure</u> reliably the fair value of an embedded derivative on the basis of its terms and conditions (for example, because the embedded derivative is based on an ~~unquoted~~ equity instrument <u>that does not have a quoted price in an active market for an identical instrument, ie a Level 1 input</u>), the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) instrument and the fair value of the host contract~~, if those can be determined under this Standard~~. If the entity is unable to ~~determine~~ <u>measure</u> the fair value of the embedded derivative using this method, paragraph 12 applies and the hybrid (combined) instrument is designated as at fair value through profit or loss.

28 When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognised and the part that is derecognised, the fair value of the part that continues to be recognised needs to be ~~determined~~ <u>measured</u>. ...

D99 Paragraph 43A is added.

43A However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG76.

D100 Paragraph 47 is amended as follows:

47 After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an ~~unquoted~~ equity instrument <u>that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)</u> whose fair value cannot <u>otherwise</u> be reliably measured, which shall be measured at cost.

…

D101 Paragraphs 48–49 are deleted.

D102 Paragraph 88 is amended as follows:

88 A hedging relationship qualifies for hedge accounting under paragraphs 89–102 if, and only if, all ~~of~~ the following conditions are met.

…

(d) The effectiveness of the hedge can be reliably measured, ie the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured ~~(see paragraphs 46 and 47 and Appendix A paragraphs AG80 and AG81 for guidance on determining fair value)~~.

…

D103 Paragraph 103Q is added as follows:

103Q HKFRS 13, issued in June 2011, amended paragraphs 9, 13, 28, 47, 88, AG46, AG52, AG64, AG76, AG76A, AG80, AG81 and AG96, added paragraph 43A and deleted paragraphs 48–49, AG69–AG75, AG77–AG79 and AG82. An entity shall apply those amendments when it applies HKFRS 13.

D104 In Appendix A paragraphs AG46, AG52 and AG64 are amended as follows:

AG46 ~~In estimating~~ <u>When measuring</u> the fair values of the part that continues to be recognised and the part that is derecognised for the purposes of applying paragraph 27, an entity applies the fair value measurement requirements in <u>HKFRS 13</u> ~~and paragraphs 48–49 and AG69–AG82~~ in addition to paragraph 28.

AG52 This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans … The fair value of the loans at the date of the transaction is CU10,100 and the ~~estimated~~ fair value of the excess spread of 0.5 per cent is CU40.

…

The entity calculates the gain or loss on the sale of the 90 per cent share of cash flows. Assuming that separate fair values of the 90 per cent part transferred and the 10 per cent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 28 as follows:

	~~Estimated fair~~ <u>Fair</u> value	*Percentage*	*Allocated carrying amount*
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
Total	**10,100**		**10,000**

…

D105 Paragraph AG64 is amended as follows:

AG64 The fair value of a financial instrument on initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also <u>HKFRS 13 and</u> paragraph AG76). However, if part of the consideration given or received is for something other than the financial instrument, <u>an entity shall measure</u> the fair value of the financial instrument ~~is estimated using a valuation technique (see paragraphs AG74–AG79)~~. For example, the fair value of a long-term loan or receivable that carries no interest can be ~~estimated~~ <u>measured</u> as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

D106 Paragraphs AG69–AG75 and their related headings are deleted.

D107 Paragraph AG76 is amended as follows:

AG76 ~~Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (ie without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased.~~ The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also HKFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 43A, the entity shall account for ~~unless the fair value of~~ that instrument at that date as follows:

(a) at the measurement required by paragraph 43 if that fair value is evidenced by ~~comparison with other observable current market transactions in the same instrument (ie without modification or repackaging)~~ a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique ~~whose variables include~~ that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 43, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

D108 Paragraph AG76A is amended as follows:

AG76A The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard. ~~The application of paragraph AG76 may result in no gain or loss being recognised on the initial recognition of a financial asset or financial liability. In such a case, HKAS 39 requires that a gain or loss shall be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.~~

D109 Paragraphs AG77–AG79 are deleted.

D110 Paragraphs AG80 and AG81 are amended as follows:

AG80 The fair value of investments in equity instruments that do not have a quoted ~~market~~ price in an active market for an identical instrument (ie a Level 1 input) and derivatives that are linked to and must be settled by delivery of such an ~~unquoted~~ equity instrument (see paragraphs 46(c) and 47) is reliably measurable if (a) the variability in the range of reasonable fair value ~~estimates~~ measurements is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used ~~in estimating~~ when measuring fair value.

AG81 There are many situations in which the variability in the range of reasonable fair value ~~estimates~~ measurements of investments in equity instruments that do not have a quoted ~~market~~ price in an active market for an identical instrument (ie a Level 1 input) and derivatives that are linked to and must be settled by delivery of such an ~~unquoted~~ equity instrument (see paragraphs 46(c) and 47) is likely not to be significant. Normally it is possible to ~~estimate~~ measure the fair value of a financial asset that an entity has acquired from an outside party. However, if the range of reasonable fair value ~~estimates~~ measurements is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

D111 The heading above paragraph AG82 and paragraph AG82 are deleted.

D112 Paragraph AG96 is amended as follows:

AG96 An investment in an ~~unquoted~~ equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input) is not carried at fair value because its fair value cannot otherwise be reliably measured or a derivative that is linked to and must be settled by delivery of such an ~~unquoted~~ equity instrument (see paragraphs 46(c) and 47) cannot be designated as a hedging instrument.

HKAS 40 *Investment Property*

D113 Paragraph IN16 is amended as follows:

IN16 In exceptional cases, when an entity has adopted the fair value model, there may be clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that its fair value will not be reliably ~~determinable~~ measurable on a continuing basis. …

D114 Paragraphs 26, 29 and 32 are amended as follows:

26 … Guidance on ~~determining~~ measuring the fair value of a property interest is set out for the fair value model in paragraphs 33–35, 40, 41, 48, 50 and 52 and in HKFRS 13. That guidance is also relevant to the ~~determination~~ measurement of fair value when that value is used as cost for initial recognition purposes.

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

32 This Standard requires all entities to ~~determine~~ measure the fair value of investment property, for the purpose of either measurement (if the entity uses the fair value model) or disclosure (if it uses the cost model). An entity is encouraged, but not required, to ~~determine~~ measure the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent

experience in the location and category of the investment property being valued.

D115 Paragraphs 36–39 are deleted.

D116 Paragraph 40 is amended as follows:

40 When measuring the ~~The~~ fair value of investment property in accordance with HKFRS 13, an entity shall ensure that the fair value reflects, among other things, rental income from current leases and ~~reasonable and supportable~~ other assumptions that ~~represent what knowledgeable, willing parties~~ market participants would ~~assume~~ use when pricing the investment property ~~about rental income from future leases in the light of~~ under current market conditions. ~~It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognised in the financial statements until a later date (eg periodic payments such as contingent rents).~~

D117 Paragraphs 42–47, 49 and 51 are deleted.

D118 Paragraph 48 is amended as follows:

48 In exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the variability in the range of reasonable fair value ~~estimates~~ measurements will be so great, and the probabilities of the various outcomes so difficult to assess, that the usefulness of a single ~~estimate~~ measure of fair value is negated. This may indicate that the fair value of the property will not be reliably ~~determinable~~ measurable on a continuing basis (see paragraph 53).

D119 The heading above paragraph 53 and paragraphs 53 and 53B are amended as follows:

Inability to ~~determine~~ measure fair value reliably

53 There is a rebuttable presumption that an entity can reliably ~~determine~~ measure the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the investment property is not reliably ~~determinable~~ measurable on a continuing basis. This arises when, and only when, the market for comparable ~~market~~ properties is inactive (eg there are few recent transactions, price quotations are not current or observed transaction prices indicate that the seller was forced to sell) ~~are infrequent~~ and alternative reliable ~~estimates~~ measurements of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably ~~determinable~~ measurable but expects the fair value of the property to be reliably ~~determinable~~ measurable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably ~~determinable~~ measurable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not

reliably ~~determinable~~ measurable on a continuing basis, the entity shall measure that investment property using the cost model in HKAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply HKAS 16 until disposal of the investment property.

53B … An entity that has measured an item of investment property under construction at fair value may not conclude that the fair value of the completed investment property cannot be ~~determined~~ measured reliably.

D120 Paragraph 75(d) is deleted.

D121 Paragraphs 78–80 are amended as follows:

78 In the exceptional cases referred to in paragraph 53, when an entity measures investment property using the cost model in HKAS 16, the reconciliation required by paragraph 76 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:

…

(b) an explanation of why fair value cannot be ~~determined~~ measured reliably;

…

79 In addition to the disclosures required by paragraph 75, an entity that applies the cost model in paragraph 56 shall disclose:

…

(e) the fair value of investment property. In the exceptional cases described in paragraph 53, when an entity cannot ~~determine~~ measure the fair value of the investment property reliably, it shall disclose:

…

(ii) an explanation of why fair value cannot be ~~determined~~ measured reliably; and

…

80 An entity that has previously applied SSAP 13 (2000) and elects for the first time to classify and account for some or all eligible property interests held under operating leases as investment property shall recognise the effect of that election as an adjustment to the opening balance of retained earnings for the period in which the election is first made. In addition:

(a) if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods (~~determined~~ measured on a basis that satisfies the definition of fair value in ~~paragraph 5 and the guidance in paragraphs 36–52~~ HKFRS 13), the entity is encouraged, but not required:

…

D122 Paragraph 85B is amended as follows:

85B … An entity is permitted to apply the amendments to investment property under construction from any date before 1 January 2009 provided that the fair values of investment properties under construction were ~~determined~~ measured at those dates. …

D123 Paragraph 85C is added as follows:

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

HKAS 41 *Agriculture*

D124 In the rubric 'paragraphs 1–60' is amended to 'paragraphs 1–61'.

D125 Paragraph IN3 is amended as follows:

IN3 There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market~~-determined~~ prices ~~or values~~ are not available and for which alternative ~~estimates of~~ fair value measurements are determined to be clearly unreliable. …

D126 Paragraphs 8, 15 and 16 are amended as follows:

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

~~**An *active market* is a market where all the following conditions exist:**~~

(a) ~~**the items traded within the market are homogeneous;**~~

(b) ~~**willing buyers and sellers can normally be found at any time; and**~~

(c) ~~**prices are available to the public.**~~

...

***Fair value* is the** ~~**amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction**~~ **price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)**

15 The ~~determination of~~ fair value measurement of ~~for~~ a biological asset or agricultural produce may be facilitated by grouping biological assets or agricultural produce according to significant attributes; for example, by age or quality. …

16 Entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in ~~determining~~ measuring fair value, because fair value reflects the current market conditions in which ~~a willing buyer and seller~~ market participant buyers and sellers would enter into a transaction. …

D127 Paragraphs 9, 17–21 and 23 are deleted.

D128 Paragraphs 25 and 30 are amended as follows:

25 … An entity may use information regarding the combined assets to ~~determine~~ measure the fair value ~~for~~ of the biological assets. …

30 There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market-~~determined~~ prices ~~or values~~ are not available and for which alternative ~~estimates of~~ fair value measurements are determined to be clearly unreliable. …

D129 Paragraphs 47 and 48 are deleted.

D130 Paragraph 61 is added as follows:

61 HKFRS 13, issued in June 2011, amended paragraphs 8, 15, 16, 25 and 30 and deleted paragraphs 9, 17–21, 23, 47 and 48. An entity shall apply those amendments when it applies HKFRS 13.

HK(IFRIC)-Int 2 *Members' Shares in Co-operative Entities and Similar Instruments*

D131 In the rubric, 'paragraphs 1–14A' is amended to 'paragraphs 1–16'

D132 Below the heading 'References' a reference to HKFRS 13 *Fair Value Measurement* is added.

D133 Paragraph 16 is added as follows:

16 HKFRS 13, issued in June 2011, amended paragraph A8. An entity shall apply that amendment when it applies HKFRS 13.

D134 In the Appendix paragraph A8 is amended as follows:

A8 Members' shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity ~~determines~~ measures the fair value of such financial liabilities as required by paragraph ~~49 of HKAS 39~~ 47 of HKFRS 13, which states: 'The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand …' Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*

D135 Below the heading ‘References’ a reference to HKFRS 13 *Fair Value Measurement* is added.

D136 In paragraph 15(a) ‘fair value’ is footnoted as follows:

* HKAS 17 uses the term ‘fair value’ in a way that differs in some respects from the definition of fair value in HKFRS 13. Therefore, when applying HKAS 17 an entity measures fair value in accordance with HKAS 17, not HKFRS 13.

HK(IFRIC)-Int 13 *Customer Loyalty Programmes*

D137 Below the heading ‘References’ a reference to HKFRS 13 *Fair Value Measurement* is added.

D138 Paragraph 6 is amended as follows:

6 The consideration allocated to the award credits shall be measured by reference to their fair value~~, ie the amount for which the award credits could be sold separately~~.

D139 Paragraph 10B is added as follows:

10B HKFRS 13, issued in June 2011, amended paragraphs 6 and AG1–AG3. An entity shall apply those amendments when it applies HKFRS 13.

D140 In the Application Guidance paragraphs AG1–AG3 are amended as follows:

AG1 Paragraph 6 of the consensus requires the consideration allocated to award credits to be measured by reference to their fair value~~, ie the amount for which the award credits could be sold separately~~. If ~~the fair value~~ there is not ~~directly observable~~ a quoted market price for an identical award credit, ~~it~~ fair value must be ~~estimated~~ measured using another valuation technique.

AG2 An entity may ~~estimate~~ measure the fair value of award credits by reference to the fair value of the awards for which they could be redeemed. The fair value of the award credits takes into account, as appropriate:

(a) the amount of the discounts or incentives that would otherwise be offered to customers who have not earned award credits from an initial sale; ~~and~~

(b) the proportion of award credits that are not expected to be redeemed by customers~~.~~ ; and

(c) non-performance risk.

If customers can choose from a range of different awards, the fair value of the award credits ~~will~~ reflects the fair values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

AG3 In some circumstances, other ~~estimation~~ valuation techniques may be ~~available~~ used. For example, if a third party will supply the awards and the entity pays the third party for each award credit it grants, it could ~~estimate~~ measure the fair value of the award credits by reference to the amount it pays the third party, adding a reasonable profit margin. Judgement is required to select and apply the ~~estimation~~ valuation technique that satisfies the requirements of paragraph 6 of the consensus and is most appropriate in the circumstances.

HK(IFRIC)-Int 17 *Distributions of Non-cash Assets to Owners*

D141 In the rubric 'paragraphs 1–19' is amended to 'paragraphs 1–20'.

D142 Below the heading 'References' a reference to HKFRS 13 *Fair Value Measurement* is added.

D143 Paragraph 17 is amended as follows:

17 If, after the end of a reporting period but before the financial statements are authorised for issue, an entity declares a dividend to distribute a non-cash asset, it shall disclose:

…

(c) the ~~estimated~~ fair value of the asset to be distributed as of the end of the reporting period, if it is different from its carrying amount, and the information about the method(s) used to ~~determine~~ measure that fair value required by ~~HKFRS 7 paragraph 27–27B(a)~~ paragraphs 93(b), (d), (g) and (i) and 99 of HKFRS 13.

D144 Paragraph 20 is added as follows:

20 HKFRS 13, issued in June 2011, amended paragraph 17. An entity shall apply that amendment when it applies HKFRS 13.

HK(IFRIC)-Int 19 *Extinguishing Financial Liabilities with Equity Instruments*

D145 In the rubric 'paragraphs 1–14' is amended to 'paragraphs 1–15'.

D146 Below the heading 'References' a reference to HKFRS 13 *Fair Value Measurement* is added.

D147 Paragraph 7 is amended as follows:

7 If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph ~~49~~ 47 of ~~HKAS 39~~ HKFRS 13 is not applied.

D148 Paragraph 15 is added as follows:

15 HKFRS 13, issued in June 2011, amended paragraph 7. An entity shall apply that amendment when it applies HKFRS 13.

Appendix E
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 13.

The International Financial Reporting Standard comparable with HKFRS 13 is IFRS 13 *Financial Value Measurement*.

There are no major textual differences between HKFRS 13 and IFRS 13.

HKFRS 13 BC
Issued June 2011

Basis for Conclusions on
Hong Kong Financial Reporting Standard 13

Fair Value Measurement

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

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Basis for Conclusions
HKFRS 13 *Fair Value Measurement*

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

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APPENDIX
Amendments to the Basis for Conclusions on other IFRSs

Basis for Conclusions on IFRS 13 *Fair Value Measurement*

This Basis for Conclusions accompanies, but is not part of, IFRS 13.

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) in reaching the conclusions in IFRS 13 *Fair Value Measurement*. It includes the reasons for accepting particular views and rejecting others. Individual IASB members gave greater weight to some factors than to others.

BC2 IFRS 13 is the result of the IASB's discussions about measuring fair value and disclosing information about fair value measurements in accordance with International Financial Reporting Standards (IFRSs), including those held with the US national standard-setter, the Financial Accounting Standards Board (FASB), in their joint project on fair value measurement.

BC3 As a result of those discussions, the FASB amended particular aspects of Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*® (which codified FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157)). The FASB separately developed a Basis for Conclusions summarising its considerations in reaching the conclusions resulting in those amendments.

Overview

BC4 Some IFRSs require or permit entities to measure or disclose the fair value of assets, liabilities or their own equity instruments. Because those IFRSs were developed over many years, the requirements for measuring fair value and for disclosing information about fair value measurements were dispersed and in many cases did not articulate a clear measurement or disclosure objective.

BC5 As a result, some of those IFRSs contained limited guidance about how to measure fair value, whereas others contained extensive guidance and that guidance was not always consistent across those IFRSs that refer to fair value. Inconsistencies in the requirements for measuring fair value and for disclosing information about fair value measurements have contributed to diversity in practice and have reduced the comparability of information reported in financial statements.

BC6 To remedy that situation, the IASB added a project to its agenda with the following objectives:

(a) to establish a single set of requirements for all fair value measurements required or permitted by IFRSs to reduce complexity and improve consistency in their application, thereby enhancing the comparability of information reported in financial statements;

(b) to clarify the definition of fair value and related guidance to communicate the measurement objective more clearly;

(c) to enhance disclosures about fair value measurements that will help users of financial statements assess the valuation techniques and inputs used to develop fair value measurements; and

(d) to increase the convergence of IFRSs and US generally accepted accounting principles (GAAP).

BC7 IFRS 13 is the result of that project. IFRS 13 is a single source of fair value measurement guidance that clarifies the definition of fair value, provides a clear framework for measuring fair value and enhances the disclosures about fair value measurements. It is also the result of the efforts of the IASB and the FASB to ensure that fair value has the same meaning in IFRSs and in US GAAP and that their respective fair value measurement and disclosure requirements are the same (except for minor differences in wording and style; see paragraphs BC237 and BC238 for the differences between IFRS 13 and Topic 820).

BC8 IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures. It does not introduce new fair value measurements, nor does it eliminate practicability exceptions to fair value measurements (eg the exception in IAS 41 *Agriculture* when an entity is unable to measure reliably the fair value of a biological asset on initial recognition). In other words, IFRS 13 specifies *how* an entity should measure fair value and disclose information about fair value measurements. It does not specify *when* an entity should measure an asset, a liability or its own equity instrument at fair value.

Background

BC9 The IASB and the FASB began developing their fair value measurement standards separately.

BC10 The FASB began working on its fair value measurement project in June 2003. In September 2005, during the FASB's redeliberations on the project, the IASB added to its agenda a project to clarify the meaning of fair value and to provide guidance for its application in IFRSs.

BC11 In September 2006 the FASB issued SFAS 157 (now in Topic 820). Topic 820 defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements.

BC12 In November 2006 as a first step in developing a fair value measurement standard, the IASB published a discussion paper *Fair Value Measurements*. In that discussion paper, the IASB used SFAS 157 as a basis for its preliminary views because of the consistency of SFAS 157 with the existing fair value measurement guidance in IFRSs and the need for increased convergence of IFRSs and US GAAP. The IASB received 136 comment letters in response to that discussion paper. In November 2007 the IASB began its deliberations for the development of the exposure draft *Fair Value Measurement*.

BC13 In May 2009 the IASB published that exposure draft, which proposed a definition of fair value, a framework for measuring fair value and disclosures about fair value measurements. Because the proposals in the exposure draft were developed using the requirements of SFAS 157, there were many similarities between them. However, some of those proposals were different from the requirements of SFAS 157 and many of them used wording that was similar, but not identical, to the wording in SFAS 157. The IASB received 160 comment letters in response to the proposals in the exposure draft. One of the most prevalent comments received was a request for the IASB and the FASB to work together to develop common fair value measurement and disclosure requirements in IFRSs and US GAAP.

BC14 In response to that request, the IASB and the FASB agreed at their joint meeting in October 2009 to work together to develop common requirements. The boards concluded that having common requirements for fair value measurement and disclosure would improve the comparability of financial statements prepared in accordance with IFRSs and US GAAP. In addition, they concluded that having common requirements would reduce diversity in the application of fair value measurement requirements and would simplify financial reporting. To achieve those goals, the boards needed to ensure that fair value had the same meaning in IFRSs and US GAAP and that IFRSs and US GAAP had the same fair value measurement and disclosure requirements (except for minor differences in wording and style). Consequently, the FASB agreed to consider the comments received on the IASB's exposure draft and to propose amendments to US GAAP if necessary.

BC15 The boards began their joint discussions in January 2010. They discussed nearly all the issues together so that each board would benefit from hearing the rationale for the other board's decisions on each issue. They initially focused on the following:

(a) differences between the requirements in Topic 820 and the proposals in the IASB's exposure draft;

(b) comments received on the IASB's exposure draft (including comments received from participants at the IASB's round-table meetings held in November and December 2009); and

(c) feedback received on the implementation of Topic 820 (eg issues discussed by the FASB's Valuation Resource Group).

BC16 In March 2010 the boards completed their initial discussions. As a result of those discussions, in June 2010 the FASB issued a proposed Accounting Standards Update (ASU) *Fair Value Measurements and Disclosures (Topic 820): Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* and the IASB re-exposed a proposed disclosure of the unobservable inputs used in a fair value measurement (*Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*). The IASB concluded that it was necessary to re-expose that proposal because in their discussions the boards agreed to require a measurement uncertainty analysis disclosure that included the effect of any interrelationships between unobservable inputs (a requirement that was not proposed in the May 2009 exposure draft and was not already required by IFRSs). The IASB received 92 comment letters on the re-exposure document.

BC17 In September 2010, after the end of the comment periods on the IASB's re-exposure document and the FASB's proposed ASU, the boards jointly considered the comments received on those exposure drafts. The boards completed their discussions in March 2011.

BC18 Throughout the process, the IASB considered information from the IFRS Advisory Council, the Analysts' Representative Group and the IASB's Fair Value Expert Advisory Panel (see paragraph BC177) and from other interested parties.

Scope

BC19 The boards separately discussed the scope of their respective fair value measurement standards because of the differences between IFRSs and US GAAP in the measurement bases specified in other standards for both initial recognition and subsequent measurement.

BC20 IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in the following circumstances:

(a) The measurement and disclosure requirements of IFRS 13 do not apply to the following:

(i) share-based payment transactions within the scope of IFRS 2 *Share-based Payment*;

(ii) leasing transactions within the scope of IAS 17 *Leases*; and

(iii) measurements that have some similarities to fair value but are not fair value, such as net realisable value in accordance with IAS 2 *Inventories* and value in use in accordance with IAS 36 *Impairment of Assets*.

(b) The disclosures required by IFRS 13 are not required for the following:

(i) plan assets measured at fair value in accordance with IAS 19 *Employee Benefits*;

(ii) retirement benefit plan investments measured at fair value in accordance with IAS 26 *Accounting and Reporting by Retirement Benefit Plans*; and

(iii) assets for which recoverable amount is fair value less costs of disposal in accordance with IAS 36.

BC21 The exposure draft proposed introducing a new measurement basis for IFRS 2, a market-based value. The definition of *market-based value* would have been similar to the exit price definition of fair value except that it would specify that the measurement does not take into account market participant assumptions for vesting conditions and reload features. Respondents pointed out that some items measured at fair value in IFRS 2 were consistent with the proposed definition of fair value, not with the proposed definition of market-based value, and were concerned that there could be unintended consequences of moving forward with a market-based value measurement basis in IFRS 2. The IASB agreed with those comments and concluded that amending IFRS 2 to distinguish between measures that are fair value and those based on fair value would require new measurement guidance for measures based on fair value. The IASB concluded that such guidance might result in unintended changes in practice with regard to measuring share-based payment transactions and decided to exclude IFRS 2 from the scope of IFRS 13.

BC22 The IASB concluded that applying the requirements in IFRS 13 might significantly change the classification of leases and the timing of recognising gains or losses for sale and leaseback transactions. Because there is a project under way to replace IAS 17, the IASB concluded that requiring entities to make potentially significant changes to their accounting systems for the IFRS on fair value measurement and then for the IFRS on lease accounting could be burdensome.

BC23 The exposure draft proposed that the disclosures about fair value measurements would be required for the fair value of plan assets in IAS 19 and the fair value of retirement benefit plan investments in IAS 26. In its project to amend IAS 19 the IASB decided to require an entity to disaggregate the fair value of the plan assets into classes that distinguish the risk and liquidity characteristics of those assets, subdividing each class of debt and equity instruments into those that have a quoted market price in an active market and those that do not. As a result, the IASB decided that an entity does not need to provide the disclosures required by IFRS 13 for the fair value of plan assets or retirement benefit plan investments.

BC24 The exposure draft was not explicit about whether the measurement and disclosure requirements in the exposure draft applied to measurements based on fair value, such as fair value less costs to sell in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* or IAS 41. In the boards' discussions, they concluded that the measurement and disclosure requirements should apply to all measurements for which fair value is the underlying measurement basis (except that the disclosure requirements would not apply to assets with a recoverable amount that is fair value less costs of disposal in IAS 36; see paragraphs BC218–BC221). Consequently, the boards decided to clarify that the measurement and disclosure requirements apply to both fair value measurements and measurements based on fair value. The boards also decided to clarify that the measurement and disclosure requirements do not apply to measurements that have similarities to fair value but are not fair value, such as net realisable value in accordance with IAS 2 or value in use in accordance with IAS 36.

BC25 The boards decided to clarify that the measurement requirements apply when measuring the fair value of an asset or a liability that is not measured at fair value in the statement of financial position but for which the fair value is disclosed (eg for financial instruments subsequently measured at amortised cost in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement* and for investment property subsequently measured using the cost model in accordance with IAS 40 *Investment Property*).

BC26 The IASB decided that two of the proposals about scope in the exposure draft were not necessary:

(a) The exposure draft proposed excluding financial liabilities with a demand feature in IAS 39 from the scope of an IFRS on fair value measurement. In the light of the comments received, the IASB confirmed its decision when developing IAS 39 that the fair value of financial liabilities with a demand feature cannot be less than the present value of the demand amount (see paragraphs BC101–BC103) and decided to retain the term *fair value* for such financial liabilities.

(b) The exposure draft proposed replacing the term *fair value* with another term that reflects the measurement objective for reacquired rights in a business combination in IFRS 3 *Business Combinations*. In the redeliberations, the IASB concluded that because IFRS 3 already describes the measurement of reacquired rights as an exception to fair value, it was not necessary to change that wording.

Measurement

Definition of fair value

Clarifying the measurement objective

BC27 IFRS 13 defines fair value as:

> The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

BC28 IFRS 13 also provides a framework that is based on an objective to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (ie an exit price from the perspective of a market participant that holds the asset or owes the liability at the measurement date).

BC29 That definition of fair value retains the exchange notion contained in the previous definition of fair value in IFRSs:

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

BC30 Like the previous definition of fair value, the revised definition assumes a hypothetical and orderly exchange transaction (ie it is not an actual sale or a forced transaction or distress sale). However, the previous definition of fair value:

(a) did not specify whether an entity is buying or selling the asset;

(b) was unclear about what is meant by settling a liability because it did not refer to the creditor, but to knowledgeable, willing parties; and

(c) did not state explicitly whether the exchange or settlement takes place at the measurement date or at some other date.

BC31 The IASB concluded that the revised definition of fair value remedies those deficiencies. It also conveys more clearly that fair value is a market-based measurement, and not an entity-specific measurement, and that fair value reflects current market conditions (which reflect market participants', not the entity's, current expectations about future market conditions).

BC32 In determining how to define fair value in IFRSs, the IASB considered work done in its project to revise IFRS 3. In that project, the IASB considered whether differences between the definitions of fair value in US GAAP (an explicit exit price) and IFRSs (an exchange amount, which might be interpreted in some situations as an entry price) would result in different measurements of assets acquired and liabilities assumed in a business combination. That was a particularly important issue because in many business combinations the assets and liabilities are non-financial.

BC33 The IASB asked valuation experts to take part in a case study involving the valuation of the identifiable assets acquired and liabilities assumed in a sample business combination. The IASB learned that differences between an exit price and an exchange amount (which might be interpreted as an entry price in a business combination) were unlikely to arise, mainly because transaction costs are not a component of fair value in either definition. The IASB observed that although the definitions used different words, they articulated essentially the same concepts.

BC34 However, the valuation experts identified potential differences in particular areas. The valuation experts told the IASB that an exit price for an asset acquired or a liability assumed in a business combination might differ from an exchange amount if:

(a) an entity's intended use for an acquired asset is different from its highest and best use by market participants (ie when the acquired asset provides defensive value); or

(b) a liability is measured on the basis of settling it with the creditor rather than transferring it to a third party and the entity determines that there is a difference between those measurements. Paragraphs BC80–BC82 discuss perceived differences between the settlement and transfer notions.

BC35 With respect to highest and best use, the IASB understood that the ways of measuring assets on the basis of their defensive value (ie the value associated with improving the prospects of the entity's other assets by preventing the acquired asset from being used by competitors) in accordance with US GAAP at the time IFRS 3 was issued were still developing. As a consequence, the IASB thought it was too early to assess the significance of any differences that might result. With respect to liabilities, it was also not clear at that time whether entities would use different valuation techniques to measure the fair value of liabilities assumed in a business combination. In the development of IFRS 13, the IASB observed the discussions of the FASB's Valuation Resource Group to learn from the implementation of SFAS 157 and Topic 820 in US GAAP.

Fair value as a current exit price

BC36 The definition of fair value in IFRS 13 is a current exit price. That definition in and of itself is not a controversial issue. Many respondents thought the proposal to define fair value as a current, market-based exit price was appropriate because that definition retains the notion of an exchange between unrelated, knowledgeable and willing parties in the previous definition of fair value in IFRSs, but provides a clearer measurement objective. Other respondents thought an entry price would be more appropriate in some situations (eg at initial recognition, such as in a business combination).

BC37 However, the issue of *when* fair value should be used as a measurement basis in IFRSs is controversial. There is disagreement about the following:

(a) which assets and liabilities should be measured at fair value (eg whether fair value should be restricted to assets and liabilities with quoted prices in active markets that the entity intends to sell or transfer in the near term);

(b) when those assets and liabilities should be measured at fair value (eg whether the measurement basis should change when markets have become less active); and

(c) where any changes in fair value should be recognised.

BC38 Although IFRS 13 does not address when fair value should be used as a measurement basis for a particular asset or liability or revisit when fair value has been used in IFRSs, the IASB did consider whether each use of the term *fair value* in IFRSs was consistent with an exit price definition (see paragraphs BC41–BC45). Furthermore, IFRS 13 will inform the IASB in the future as it considers whether to require fair value as a measurement basis for a particular type of asset or liability.

BC39 The IASB concluded that an exit price of an asset or a liability embodies expectations about the future cash inflows and outflows associated with the asset or liability from the perspective of a market participant that holds the asset or owes the liability at the measurement date. An entity generates cash inflows from an asset by using the asset or by selling it. Even if an entity intends to generate cash inflows from an asset by using it rather than by selling it, an exit price embodies expectations of cash flows arising from the use of the asset by selling it to a market participant that would use it in the same way. That is because a market participant buyer will pay only for the benefits it expects to generate from the use (or sale) of the asset. Thus, the IASB concluded that an exit price is always a relevant definition of fair value for assets, regardless of whether an entity intends to use an asset or sell it.

BC40 Similarly, a liability gives rise to outflows of cash (or other economic resources) as an entity fulfils the obligation over time or when it transfers the obligation to another party. Even if an entity intends to fulfil the obligation over time, an exit price embodies expectations of related cash outflows because a market participant transferee would ultimately be required to fulfil the obligation. Thus, the IASB concluded that an exit price is always a relevant definition of fair value for liabilities, regardless of whether an entity intends to fulfil the liability or transfer it to another party that will fulfil it.

BC41 In developing the revised definition of fair value, the IASB completed a standard-by-standard review of fair value measurements required or permitted in IFRSs to assess whether the IASB or its predecessor intended each use of fair value to be a current exit price measurement basis. If it became evident that a current exit price was not the intention in a particular situation, the IASB would use another measurement basis to describe the objective. The other likely measurement basis candidate was a current entry price. For the standard-by-standard review, the IASB defined current entry price as follows:

> The price that would be paid to buy an asset or received to incur a liability in an orderly transaction between market participants (including the amount imposed on an entity for incurring a liability) at the measurement date.

BC42 That definition of current entry price, like fair value, assumes a hypothetical orderly transaction between market participants at the measurement date. It is not necessarily the same as the price an entity paid to acquire an asset or received to incur a liability, eg if that transaction was not at arm's length. In discussions with interested parties, the IASB found that most people who assert that an asset or a liability should be measured using an entry price measurement basis, rather than an exit price measurement basis, would actually prefer to use the entity's actual transaction price (or cost), not the market-based current entry price defined above. The IASB observed that in some cases there is not an actual transaction price (eg when a group of assets is acquired but the unit of account is an individual asset, or when a biological asset regenerates) and, as a result, an assumed, or hypothetical, price must be used.

BC43 During the standard-by-standard review, the IASB asked various parties to provide information on whether, in practice, they interpreted fair value in a particular context in IFRSs as a current entry price or a current exit price. The IASB used that information in determining whether to define fair value as a current exit price, or to remove the term *fair value* and use the terms *current exit price* and *current entry price* depending on the measurement objective in each IFRS that used the term *fair value*.

BC44 As a result of the standard-by-standard review, the IASB concluded that a current entry price and a current exit price will be equal when they relate to the same asset or liability on the same date in the same form in the same market. Therefore, the IASB considered it unnecessary to make a distinction between a current entry price and a current exit price in IFRSs with a market-based measurement objective (ie fair value), and the IASB decided to retain the term fair value and define it as a current exit price.

BC45 The IASB concluded that some fair value measurement requirements in IFRSs were inconsistent with a current exit price or the requirements for measuring fair value. For those fair value measurements, IFRS 13 excludes the measurement from its scope (see paragraphs BC19–BC26).

The asset or liability

BC46 IFRS 13 states that a fair value measurement takes into account the characteristics of the asset or liability, eg the condition and location of the asset and restrictions, if any, on its sale or use. Restrictions on the sale or use of an asset affect its fair value if market participants would take the restrictions into account when pricing the asset at the measurement date. That is consistent with the fair value measurement guidance already in IFRSs. For example:

(a) IAS 40 stated that an entity should identify any differences between the property being measured at fair value and similar properties for which observable market prices are available and make the appropriate adjustments; and

(b) IAS 41 referred to measuring the fair value of a biological asset or agricultural produce in its present location and condition.

BC47 The IASB concluded that IFRS 13 should describe how to measure fair value, not what is being measured at fair value. Other IFRSs specify whether a fair value measurement considers an individual asset or liability or a group of assets or liabilities (ie the unit of account). For example:

(a) IAS 36 states that an entity should measure the fair value less costs of disposal for a cash-generating unit when assessing its recoverable amount.

(b) In IAS 39 and IFRS 9 the unit of account is generally an individual financial instrument.

The transaction

BC48 The exposure draft proposed that the transaction to sell an asset or transfer a liability takes place in the most advantageous market to which the entity has access. That was different from the approach in Topic 820, which refers to the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The IASB concluded that in most cases the principal market for an asset or a liability will be the most advantageous market and that an entity need not continuously monitor different markets in order to determine which market is most advantageous at the measurement date. That proposal contained a presumption that the market in which the entity normally enters into transactions for the asset or liability is the most advantageous market and that an entity may assume that the principal market for the asset or liability is the most advantageous market.

BC49 Many respondents agreed with the most advantageous market notion because most entities enter into transactions that maximise the price received to sell an asset or minimise the price paid to transfer a liability. Furthermore, they thought that a most advantageous market notion works best for all assets and liabilities, regardless of the level of activity in a market or whether the market for an asset or a liability is observable.

BC50 However, some respondents were concerned about the difficulty with identifying and selecting the most advantageous market when an asset or a liability is exchanged in multiple markets throughout the world. Other respondents found the guidance confusing because it was not clear whether the most advantageous market must be used or how the market in which the entity normally enters into transactions relates to the principal market or to the most advantageous market. In general, respondents preferred the approach in Topic 820.

BC51 Although the boards think that in most cases the principal market and the most advantageous market would be the same, they concluded that the focus should be on the principal market for the asset or liability and decided to clarify the definition of the principal market.

BC52 Some respondents to the exposure draft stated that the language in US GAAP was unclear about whether the principal market should be determined on the basis of the volume or level of activity *for the asset or liability* or on the volume or level of activity *of the reporting entity's transactions in a particular market*. Consequently, the boards decided to clarify that the principal market is the market for the asset or liability that has the greatest volume or level of activity *for the asset or liability.* Because the principal market is the most liquid market for the asset or liability, that market will provide the most representative input for a fair value measurement. As a result, the boards also decided to specify that a transaction to sell an asset or to transfer a liability takes place in the principal (or most advantageous) market, provided that the entity can access that market on the measurement date.

BC53 In addition, the boards concluded that an entity normally enters into transactions in the principal market for the asset or liability (ie the most liquid market, assuming that the entity can access that market). As a result, the boards decided to specify that an entity can use the price in the market in which it normally enters into transactions, unless there is evidence that the principal market and that market are not the same. Consequently, an entity does not need to perform an exhaustive search for markets that might have more activity for the asset or liability than the market in which that entity normally enters into transactions. Thus, IFRS 13 addresses practical concerns about the costs of searching for the market with the greatest volume or level of activity for the asset or liability.

BC54 The boards also concluded that the determination of the most advantageous market (which is used in the absence of a principal market) for an asset or a liability takes into account both transaction costs and transport costs. However, regardless of whether an entity measures fair value on the basis of the price in the principal market or in the most advantageous market, the fair value measurement takes into account transport costs, but not transaction costs (see paragraphs BC60–BC62 for a discussion on transport and transaction costs). That is consistent with the proposal in the exposure draft.

Market participants

BC55 IFRS 13 states that a fair value measurement is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement uses the assumptions that market participants would use when pricing the asset or liability.

BC56 The previous definition of fair value in IFRSs referred to 'knowledgeable, willing parties in an arm's length transaction'. The IASB concluded that the previous definition expressed the same notion as the definition of fair value in IFRS 13, but that the previous definition was less clear. Thus, IFRS 13 defines market participants as buyers and sellers in the principal (or most advantageous) market for the asset or liability who are independent of each other (ie they are not related parties), knowledgeable about the asset or liability, and able and willing to enter into a transaction for the asset or liability.

Independence

BC57 IFRS 13 states that market participants are independent of each other (ie they are not related parties). That is consistent with the proposal in the exposure draft. Given that proposal, some respondents noted that in some jurisdictions entities often have common ownership (eg state-owned enterprises or entities with cross ownership) and questioned whether transactions observed in those jurisdictions would be permitted as an input into a fair value measurement. The boards decided to clarify that the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms. The boards concluded that this is consistent with IAS 24 *Related Party Disclosures*.

Knowledge

BC58 The exposure draft stated that market participants were presumed to be as knowledgeable as the entity about the asset or liability. Some respondents questioned that conclusion because they thought the entity might have access to information that is not available to other market participants (information asymmetry).

BC59 In the IASB's view, if a market participant is willing to enter into a transaction for an asset or a liability, it would undertake efforts, including usual and customary due diligence efforts, necessary to become knowledgeable about the asset or liability and would factor any related risk into the measurement.

The price

BC60 IFRS 13 states that the price used to measure fair value should not be reduced (for an asset) or increased (for a liability) by the costs an entity would incur when selling the asset or transferring the liability (ie transaction costs).

BC61 Some respondents stated that transaction costs are unavoidable when entering into a transaction for an asset or a liability. However, the IASB noted that the costs may differ depending on how a particular entity enters into a transaction. Therefore, the IASB concluded that transaction costs are not a characteristic of an asset or a liability, but a characteristic of the transaction. That decision is consistent with the requirements for measuring fair value already in IFRSs. An entity accounts for those costs in accordance with relevant IFRSs.

BC62 Transaction costs are different from transport costs, which are the costs that would be incurred to transport the asset from its current location to its principal (or most advantageous) market. Unlike transaction costs, which arise from a transaction and do not change the characteristics of the asset or liability, transport costs arise from an event (transport) that does change a characteristic of an asset (its location). IFRS 13 states that if location is a characteristic of an asset, the price in the principal (or most advantageous) market should be adjusted for the costs that would be incurred to transport the asset from its current location to that market. That is consistent with the fair value measurement guidance already in IFRSs. For example, IAS 41 required an entity to deduct transport costs when measuring the fair value of a biological asset or agricultural produce.

Application to non-financial assets

Distinguishing between financial assets, non-financial assets and liabilities

BC63 The exposure draft stated that the concepts of highest and best use and valuation premise would not apply to financial assets or to liabilities.

The IASB reached that conclusion for the following reasons:

(a) Financial assets do not have alternative uses because a financial asset has specific contractual terms and can have a different use only if the characteristics of the financial asset (ie the contractual terms) are changed. However, a change in characteristics causes that particular asset to become a different asset. The objective of a fair value measurement is to measure the asset that exists at the measurement date.

(b) Even though an entity may be able to change the cash flows associated with a liability by relieving itself of the obligation in different ways, the different ways of doing so are not alternative uses. Moreover, although an entity might have entity-specific advantages or disadvantages that enable it to fulfil a liability more or less efficiently than other market participants, those entity-specific factors do not affect fair value.

(c) Those concepts were originally developed within the valuation profession to value non-financial assets, such as land.

BC64 Before the amendments to Topic 820, US GAAP specified that the concepts of highest and best use and valuation premise applied when measuring the fair value of assets, but it did not distinguish between financial assets and non-financial assets.

BC65 The FASB agreed with the IASB that the concepts of highest and best use and valuation premise are relevant when measuring the fair value of non-financial assets, and are not relevant when measuring the fair value of financial assets or the fair value of liabilities. The boards also concluded that those concepts do not apply to an entity’s own equity instruments because those arrangements, similar to financial instruments, typically have specific contractual terms. Paragraphs BC108–BC131 describe the boards’ rationale in developing the requirements for measuring the fair value of financial assets and financial liabilities with offsetting positions in market risks and counterparty credit risk.

BC66 Some respondents to the FASB's proposed ASU were concerned that limiting the highest and best use concept to non-financial assets removed the concept of value maximisation by market participants, which they considered fundamental to a fair value measurement for financial assets and financial liabilities.

BC67 The boards decided to clarify that although there are no excess returns available from holding financial assets and financial liabilities within a portfolio (because in an efficient market, the price reflects the benefits that market participants would derive from holding the asset or liability in a diversified portfolio), a fair value measurement assumes that market participants seek to maximise the fair value of a financial or non-financial asset or to minimise the fair value of a financial or non-financial liability by acting in their economic best interest in a transaction to sell the asset or to transfer the liability in the principal (or most advantageous) market for the asset or liability. Such a transaction might involve grouping assets and liabilities in a way in which market participants would enter into a transaction, if the unit of account in other IFRSs does not prohibit that grouping.

Highest and best use

BC68 Highest and best use is a valuation concept used to value many non-financial assets (eg real estate). The highest and best use of a non-financial asset must be physically possible, legally permissible and financially feasible. In developing the proposals in the exposure draft, the IASB concluded that it was necessary to describe those three criteria, noting that US GAAP at the time did not.

BC69 Some respondents asked for further guidance about whether a use that is legally permissible must be legal at the measurement date, or if, for example, future changes in legislation can be taken into account. The IASB concluded that a use of an asset does not need to be legal at the measurement date, but must not be legally prohibited in the jurisdiction (eg if the government of a particular country has prohibited building or development in a protected area, the highest and best use of the land in that area could not be to develop it for industrial use). The illustrative examples that accompany IFRS 13 show how an asset can be zoned for a particular use at the measurement date, but how a fair value measurement can assume a different zoning if market participants would do so (incorporating the cost to convert the asset and obtain that different zoning permission, including the risk that such permission would not be granted).

BC70 IFRS 13 states that fair value takes into account the highest and best use of an asset from the perspective of market participants. That is the case even if an entity acquires an asset but, to protect its competitive position or for other reasons, the entity does not intend to use it actively or does not intend to use the asset in the same way as other market participants (eg if an intangible asset provides defensive value because the acquirer holds the asset to keep it from being used by competitors). When revising IFRS 3 in 2008, the IASB decided that an entity must recognise such an asset at fair value because the intention of IFRS 3 was that assets, both tangible and intangible, should be measured at their fair values regardless of how or whether the acquirer intends to use them (see paragraph BC262 of IFRS 3). IFRS 13 sets out requirements for measuring the fair value of those assets.

BC71 IFRS 13 does not require an entity to perform an exhaustive search for other potential uses of a non-financial asset if there is no evidence to suggest that the current use of an asset is not its highest and best use. The IASB concluded that an entity that seeks to maximise the value of its assets would use those assets at their highest and best use and that it would be necessary for an entity to consider alternative uses of those assets only if there was evidence that the current use of the assets is not their highest and best use (ie an alternative use would maximise their fair value). Furthermore, after discussions with valuation professionals, the IASB concluded that in many cases it would be unlikely for an asset's current use not to be its highest and best use after taking into account the costs to convert the asset to the alternative use.

BC72 When the IASB was developing the proposals in the exposure draft, users of financial statements asked the IASB to consider how to account for assets when their highest and best use within a group of assets is different from their current use by the entity (ie when there is evidence that the current use of the assets is not their highest and best use, and an alternative use would maximise their fair value). For example, the fair value of a factory is linked to the value of the land on which it is situated. The fair value of the factory would be nil if the land has an alternative use that assumes the factory is demolished. The IASB concluded when developing the exposure draft that measuring the factory at nil would not provide useful information when an entity is using that factory in its operations. In particular, users would want to see depreciation on that factory so that they could assess the economic resources consumed in generating cash flows from its operation. Therefore, the exposure draft proposed requiring an entity to separate the fair value of the asset group into its current use and fair value components.

BC73 Respondents found that proposal confusing and thought that calculating two values for a non-financial asset would be costly. As a result, the boards decided that when an entity uses a non-financial asset in a way that differs from its highest and best use (and that asset is measured at fair value), the entity must simply disclose that fact and why the asset is being used in a manner that differs from its highest and best use (see paragraphs BC213 and BC214).

Valuation premise

Terminology

BC74 As an application of the highest and best use concept, the exposure draft identified two valuation premises that may be relevant when measuring the fair value of an asset:

(a) The *in-use valuation premise*, which applies when the highest and best use of an asset is to use it with other assets or with other assets and liabilities as a group. The in-use valuation premise assumes that the exit price would be the price for a sale to a market participant that has, or can obtain, the other assets and liabilities needed to generate cash inflows by using the asset (complementary assets and the associated liabilities).

(b) The *in-exchange valuation premise*, which applies when the highest and best use of an asset is to use it on a stand-alone basis. It assumes that the sale would be to a market participant that uses the asset on a stand-alone basis.

BC75 Many respondents found the terms *in use* and *in exchange* confusing because they thought that the terminology did not accurately reflect the objective of the valuation premise (ie in both cases the asset is being exchanged, and both cases involve an assessment of how the asset will be used by market participants). In addition, some respondents stated that the in-use valuation premise could be confused with the term *value in use*, as defined in IAS 36.

BC76 In response, the boards decided to remove the terms *in use* and *in exchange* and instead describe the objective of the valuation premise: the valuation premise assumes that an asset would be used either (a) in combination with other assets or with other assets and liabilities (formerly referred to as *in use*) or (b) on a stand-alone basis (formerly referred to as *in exchange*). Respondents to the FASB's proposed ASU generally supported that proposal. The boards concluded that the change improves the understandability of the valuation premise concept.

Valuation premise for a single non-financial asset

BC77 IFRS 13 states that the valuation premise assumes that the non-financial asset being measured at fair value is sold on its own (at the unit of account level) and should be measured accordingly, even if transactions in the asset are typically the result of sales of the asset as part of a group of assets or a business. Even when an asset is used in combination with other assets, the exit price for the asset is a price for that asset individually because a fair value measurement assumes that a market participant (buyer) of the asset already holds the complementary assets and the associated liabilities. Because the buyer is assumed to hold the other assets (and liabilities) necessary for the asset to function, that buyer would not be willing to pay more for the asset solely because it was sold as part of a group. That conclusion is consistent with the conclusion reached in IFRS 3 for measuring the fair value of the identifiable assets acquired in a business combination.

Valuation premise for specialised non-financial assets

BC78 Some respondents to the exposure draft expressed concerns about using an exit price notion for specialised non-financial assets that have a significant value when used together with other non-financial assets, for example in a production process, but have little value if sold for scrap to another market participant that does not have the complementary assets. They were concerned that an exit price would be based on that scrap value (particularly given the requirement to maximise the use of observable inputs, such as market prices) and would not reflect the value that an entity expects to generate by using the asset in its operations. However, IFRS 13 clarifies that this is not the case. In such situations, the scrap value for an individual asset would be irrelevant because the valuation premise assumes that the asset would be used in combination with other assets or with other assets and liabilities. Therefore, an exit price reflects the sale of the asset to a market participant that has, or can obtain, the complementary assets and the associated liabilities needed to use the specialised asset in its own operations. In effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset.

BC79 It is unlikely in such a situation that a market price, if available, would capture the value that the specialised asset contributes to the business because the market price would be for an unmodified asset. When a market price does not capture the characteristics of the asset (eg if that price represents the use of the asset on a stand-alone basis, not installed or otherwise configured for use, rather than in combination with other assets, installed and configured for use), that price will not represent fair value. In such a situation, an entity will need to measure fair value using another valuation technique (such as an income approach) or the cost to replace or recreate the asset (such as a cost approach) depending on the circumstances and the information available.

Application to liabilities

General principles

BC80 The exposure draft proposed that a fair value measurement assumes that a liability is transferred to a market participant at the measurement date because the liability that is the subject of the fair value measurement remains outstanding (ie it is owed by the entity and is not settled with the counterparty or otherwise extinguished at the measurement date). Because the liability is assumed to be transferred to a market participant, the liability remains outstanding and the market participant transferee, like the entity, would be required to fulfil it. The same concept applies to an entity's own equity instrument, as discussed in paragraphs BC104–BC107.

BC81 In many cases, an entity might not intend (or be able) to transfer its liability to a third party. For example, an entity might have advantages relative to the market that would make it more beneficial for the entity to fulfil the liability using its own internal resources or the counterparty might not permit the liability to be transferred to another party. However, the IASB concluded that a fair value measurement provides a market benchmark to use as a basis for assessing an entity's advantages or disadvantages in performance or settlement relative to the market (for both assets and liabilities). Therefore, when a liability is measured at fair value, the relative efficiency of an entity in settling the liability using its own internal resources appears in profit or loss over the course of its settlement, and not before.

BC82 Furthermore, even if an entity is unable to transfer its liability to a third party, the IASB concluded that the transfer notion was necessary in a fair value measurement because that notion captures market participants' expectations about the liquidity, uncertainty and other factors associated with the liability, whereas a settlement notion may not because it may incorporate entity-specific factors. In the IASB's view, the fair value of a liability from the perspective of a market participant that owes the liability is the same regardless of whether it is settled or transferred. That is because:

(a) both a settlement and a transfer of a liability reflect all costs that would be incurred to fulfil the obligation, including the market-based profit an entity and a market participant transferee desire to earn on all their activities.

(b) an entity faces the same risks when fulfilling an obligation that a market participant transferee faces when fulfilling that obligation. Neither the entity nor the market participant transferee has perfect knowledge about the timing and amount of the cash outflows, even for financial liabilities.

(c) a settlement in a fair value measurement does not assume a settlement with the counterparty over time (eg as principal and interest payments become due), but a settlement at the measurement date. Accordingly, the settlement amount in a fair value measurement reflects the present value of the economic benefits (eg payments) the counterparty would have received over time.

As a result, the IASB concluded that similar thought processes are needed to estimate both the amount to settle a liability and the amount to transfer that liability.

BC83 The exposure draft proposed that an entity could estimate the amount at which a liability could be transferred in a transaction between market participants by using the same methodology that would be used to measure the fair value of the liability held by another entity as an asset (ie the fair value of the corresponding asset). If the liability was traded as an asset, the observed price would also represent the fair value of the issuer's liability. If there was no corresponding asset (eg as would be the case with a decommissioning liability), the fair value of the liability could be measured using a valuation technique, such as the present value of the future cash outflows that market participants would expect to incur in fulfilling the obligation.

BC84 That proposal was consistent with the approach in Topic 820 in US GAAP (in August 2009, after the IASB's exposure draft was published, the FASB amended Topic 820 to provide additional guidance about measuring the fair value of liabilities). However, Topic 820 provided more guidance than the IASB's exposure draft, including additional examples for applying that guidance. Because the guidance in Topic 820 was consistent with but not identical to the proposals in the IASB's exposure draft, the boards worked together to develop a combination of the two.

BC85 The boards concluded that the objective of a fair value measurement of a liability when using a valuation technique (ie when there is not an observable market to provide pricing information about the transfer of the liability) is to estimate the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date under current market conditions.

BC86 Therefore, the boards decided to describe how an entity should measure the fair value of a liability when there is no observable market to provide pricing information about the transfer of a liability. For example, IFRS 13 states that an entity may measure the fair value of a liability by using a quoted price for an identical or a similar liability held by another party as an asset or by using another valuation technique (such as an income approach).

BC87 The boards clarified that regardless of the approach used, when there is no observable market price for the transfer of a liability and the identical liability is held by another party as an asset, an entity measures the fair value of the liability from the perspective of a market participant that holds the identical liability as an asset at the measurement date. That approach is consistent with the exposure draft and US GAAP.

BC88 Thus, in the boards' view, the fair value of a liability equals the fair value of a properly defined corresponding asset (ie an asset whose features mirror those of the liability), assuming an exit from both positions in the same market. In reaching their decision, the boards considered whether the effects of illiquidity could create a difference between those values. The boards noted that the effects of illiquidity are difficult to differentiate from credit-related effects. The boards concluded that there was no conceptual reason why the liability value would diverge from the corresponding asset value in the same market because the contractual terms are the same, unless the unit of account for the liability is different from the unit of account for the asset or the quoted price for the asset relates to a similar (but not identical) liability held as an asset.

BC89 Furthermore, the boards concluded that in an efficient market, the price of a liability held by another party as an asset must equal the price for the corresponding asset. If those prices differed, the market participant transferee (ie the party taking on the obligation) would be able to earn a profit by financing the purchase of the asset with the proceeds received by taking on the liability. In such cases the price for the liability and the price for the asset would adjust until the arbitrage opportunity was eliminated.

BC90 The exposure draft stated that when using a present value technique to measure the fair value of a liability that is not held by another party as an asset, an entity should include the compensation that a market participant would require for taking on the obligation. Topic 820 contained such a requirement. Respondents asked for clarification on the meaning of compensation that a market participant would require for taking on the obligation. Therefore, the boards decided to provide additional guidance about the compensation that market participants would require, such as the compensation for taking on the responsibility of fulfilling an obligation and for assuming the risk associated with an uncertain obligation (ie the risk that the actual cash outflows might differ from the expected cash outflows). The boards concluded that including this description will improve the application of the requirements for measuring the fair value of liabilities that are not held as assets.

BC91 Some respondents to the FASB's proposed ASU requested clarification about applying risk premiums when measuring the fair value of a liability that is not held by another party as an asset (eg a decommissioning liability assumed in a business combination) when using a present value technique. They noted that the description of present value techniques described adjustments for risk as *additions* to the discount rate, which they agreed was consistent with asset valuation, but not necessarily consistent with liability valuation in the absence of a corresponding asset. The boards reasoned that from a market participant's perspective, compensation for the uncertainty related to a liability results in an increase to the amount that the market participant would expect to receive for assuming the obligation. If that compensation was accounted for in the discount rate, rather than in the cash flows, it would result in a reduction of the discount rate used in the fair value measurement of the liability. Therefore, the boards concluded that, all else being equal, the risk associated with an asset decreases the fair value of that asset, whereas the risk associated with a liability increases the fair value of that liability. However, the boards decided not to prescribe how an entity would adjust for the risk inherent in an asset or a liability, but to state that the objective is to ensure that the fair value measurement takes that risk into account. That can be done by adjusting the cash flows or the discount rate or by adding a risk adjustment to the present value of the expected cash flows (which is another way of adjusting the cash flows).

Non-performance risk

BC92 IFRS 13 states that a fair value measurement assumes that the fair value of a liability reflects the effect of non-performance risk, which is the risk that an entity will not fulfil an obligation. Non-performance risk includes, but is not limited to, an entity's own credit risk (credit standing). That is consistent with the fair value measurement guidance already in IFRSs. For example, IAS 39 and IFRS 9 referred to making adjustments for credit risk if market participants would reflect that risk when pricing a financial instrument. However, there was inconsistent application of that principle because:

(a) IAS 39 and IFRS 9 refer to credit risk generally and do not specifically refer to the reporting entity's *own* credit risk; and

(b) there were different interpretations about how an entity's own credit risk should be reflected in the fair value of a liability using the settlement notion in the previous definition of fair value because it is unlikely that the counterparty would accept a different amount as settlement of the obligation if the entity's credit standing changed.

BC93 As a result, some entities took into account changes in their own credit risk when measuring the fair value of their liabilities, whereas other entities did not. Consequently, the IASB decided to clarify in IFRS 13 that the fair value of a liability includes an entity's own credit risk.

BC94 In a fair value measurement, the non-performance risk related to a liability is the same before and after its transfer. Although the IASB acknowledges that such an assumption is unlikely to be realistic for an actual transaction (because in most cases the reporting entity transferor and the market participant transferee are unlikely to have the same credit standing), the IASB concluded that such an assumption was necessary when measuring fair value for the following reasons:

(a) A market participant taking on the obligation would not enter into a transaction that changes the non-performance risk associated with the liability without reflecting that change in the price (eg a creditor would not generally permit a debtor to transfer its obligation to another party of lower credit standing, nor would a transferee of higher credit standing be willing to assume the obligation using the same terms negotiated by the transferor if those terms reflect the transferor's lower credit standing).

(b) Without specifying the credit standing of the entity taking on the obligation, there could be fundamentally different fair values for a liability depending on an entity's assumptions about the characteristics of the market participant transferee.

(c) Those who might hold the entity's obligations as assets would consider the effect of the entity's credit risk and other risk factors when pricing those assets (see paragraphs BC83–BC89).

The FASB reached the same conclusions when developing SFAS 157 and ASU No. 2009-05 *Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value*.

BC95 Few respondents questioned the usefulness of reflecting non-performance risk in the fair value measurement of a liability at initial recognition. However, many questioned the usefulness of doing so after initial recognition, because they reasoned that it would lead to counter-intuitive and potentially confusing reporting (ie gains for credit deterioration and losses for credit improvements). The IASB understands that these concerns are strongly held, but concluded that addressing them was beyond the scope of the fair value measurement project. The purpose of that project was to define fair value, not to determine when to use fair value or how to present changes in fair value. A measurement that does not consider the effect of an entity's non-performance risk is not a fair value measurement. The IASB addressed those concerns in developing IFRS 9 (issued in October 2010).

Liabilities issued with third-party credit enhancements

BC96 IFRS 13 includes requirements for measuring the fair value of a liability issued with an inseparable third-party credit enhancement from the issuer's perspective. Those requirements are consistent with Topic 820.

BC97 A credit enhancement (also referred to as a guarantee) may be purchased by an issuer that combines it with a liability, such as debt, and then issues the combined security to an investor. For example, debt may be issued with a financial guarantee from a third party that guarantees the issuer's payment obligations. Generally, if the issuer of the liability fails to meet its payment obligations to the investor, the guarantor has an obligation to make the payments on the issuer's behalf and the issuer has an obligation to the guarantor. By issuing debt combined with a credit enhancement, the issuer is able to market its debt more easily and can either reduce the interest rate paid to the investor or receive higher proceeds when the debt is issued.

BC98 The boards concluded that the measurement of a liability should follow the unit of account of the liability for financial reporting purposes. When the unit of account for such liabilities is the obligation without the credit enhancement, the fair value of the liability from the issuer's perspective will not equal its fair value as a guaranteed liability held by another party as an asset. Therefore, the fair value of the guaranteed liability held by another party as an asset would need to be adjusted because any payments made by the guarantor in accordance with the guarantee result in a transfer of the issuer's debt obligation from the investor to the guarantor. The issuer's resulting debt obligation to the guarantor has not been guaranteed. Consequently, the boards decided that if the third-party credit enhancement is accounted for separately from the liability, the fair value of that obligation takes into account the credit standing of the issuer and not the credit standing of the guarantor.

Restrictions preventing transfer

BC99 A restriction on an entity's ability to transfer its liability to another party is a function of the requirement to fulfil the obligation and the effect of such a restriction normally is already reflected in the price. As a result, IFRS 13 states that the fair value of a liability should not be adjusted further for the effect of a restriction on its transfer if that restriction is already included in the other inputs to the fair value measurement. However, if an entity is aware that a restriction on transfer is not already reflected in the price (or in the other inputs used in the measurement), the entity would adjust those inputs to reflect the existence of the restriction.

BC100 The boards concluded that there are two fundamental differences between the fair value measurement of an asset and the fair value measurement of a liability that justify different treatments for asset restrictions and liability restrictions. First, restrictions on the transfer of a liability relate to the performance of the obligation (ie the entity is legally obliged to satisfy the obligation and needs to do something to be relieved of the obligation), whereas restrictions on the transfer of an asset relate to the marketability of the asset. Second, nearly all liabilities include a restriction preventing the transfer of the liability, whereas most assets do not include a similar restriction. As a result, the effect of a restriction preventing the transfer of a liability, theoretically, would be consistent for all liabilities and, therefore, would require no additional adjustment beyond the factors considered in determining the original transaction price. The inclusion of a restriction preventing the sale of an asset typically results in a lower fair value for the restricted asset than for the non-restricted asset, all other factors being equal.

Measurement of financial liabilities with a demand feature

BC101 In developing IFRS 13, the IASB confirmed its decision in developing IAS 39 that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand, discounted from the first date that the amount could be required to be repaid.

BCZ102 Some comments received on the exposure draft published in 2002 preceding IAS 39 requested clarification of how to measure the fair value of financial liabilities with a demand feature (eg demand deposits) when the fair value measurement option is applied or the liability is otherwise measured at fair value. In other words, could the fair value be less than the amount payable on demand, discounted from the first date that an amount could be required to be paid (the demand amount), such as the amount of the deposit discounted for the period that the entity expects the deposit to be outstanding? Some commentators believed that the fair value of financial liabilities with a demand feature is less than the demand amount, for reasons that include the consistency of such measurement with how those financial liabilities are treated for risk management purposes.

BCZ103 In developing IAS 39 the IASB agreed that this issue should be clarified. It confirmed that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (this is now in paragraph 47 of IFRS 13). That conclusion is the same as in the original IAS 32 *Financial Instruments: Disclosure and Presentation* (issued by the IASB's predecessor body, IASC, in 1995), which is now IAS 32 *Financial Instruments: Presentation*. The IASB noted that in many cases, the market price observed for such financial liabilities is the price at which they are originated between the customer and the deposit-taker—ie the demand amount. It also noted that recognising a financial liability with a demand feature at less than the demand amount would give rise to an immediate gain on the origination of such a deposit, which the IASB believes is inappropriate.

Application to an entity's own equity instruments

BC104 The exposure draft and Topic 820 stated that although the definition of fair value refers to assets and liabilities, it also should be applied to an instrument measured at fair value that is classified in an entity's own shareholders' equity. Respondents to the discussion paper asked for explicit guidance for measuring the fair value of such instruments because Topic 820 did not contain explicit guidance. Consequently, the boards decided to describe how an entity should measure the fair value of its own equity instruments (eg when an acquirer issues equity in consideration for an acquiree in a business combination).

BC105 The exposure draft proposed requiring an entity to measure the fair value of its own equity instruments from the perspective of a market participant that holds the instrument as an asset. That was because the issuer of an equity instrument can exit from that instrument only if the instrument ceases to exist or if the entity repurchases the instrument from the holder. The FASB agreed with that conclusion.

BC106 The boards also noted that some instruments may be classified as liabilities or equity, depending on the characteristics of the transaction and the characteristics of the instrument. Examples of such instruments include contingent consideration issued in a business combination in accordance with IFRS 3 and equity warrants issued by an entity in accordance with IAS 39 or IFRS 9. The boards concluded that the requirements for measuring the fair value of an entity's own equity instruments should be consistent with the requirements for measuring the fair value of liabilities. Consequently, the boards decided to clarify that the accounting classification of an instrument should not affect that instrument's fair value measurement.

BC107 The boards decided to clarify that the objective of a fair value measurement for liabilities and an entity's own equity instruments should be an exit price from the perspective of a market participant that holds the instrument as an asset at the measurement date if there is a corresponding asset, regardless of whether there is an observable market for the instrument as an asset. That decision is consistent with the boards' decisions about the requirements for measuring the fair value of a liability.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

BC108 An entity that holds a group of financial assets and financial liabilities is exposed to market risks (ie interest rate risk, currency risk or other price risk) and to the credit risk of each of the counterparties. Financial institutions and similar entities that hold financial assets and financial liabilities often manage those instruments on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty.

BC109 The previous requirements in IFRSs and US GAAP for measuring the fair value of financial assets and financial liabilities that are managed in this way were expressed differently. Therefore, the boards concluded that it is important that IFRSs and US GAAP express the requirements for measuring the fair value of those financial instruments in the same way.

BC110 When applying IFRSs, entities applied IFRS 9 or IAS 39, which permitted an entity to take into account the effects of offsetting positions in the same market risk (or risks) when measuring the fair value of a financial asset or financial liability. Many entities were using the same approach for offsetting positions in the credit risk of a particular counterparty by analogy.

BC111 When applying US GAAP, many entities applied the in-use valuation premise when measuring the fair value of such financial assets and financial liabilities. In other words, an entity would take into account how the fair value of each financial asset or financial liability might be affected by the combination of that asset or liability with other financial assets or financial liabilities held by the entity. Other entities applied the in-exchange valuation premise to the entity's net risk exposure and assumed that the transaction took place for the net position, not for the individual assets and liabilities making up that position. Those differing applications of the valuation premise arose because Topic 820 did not specify the valuation premise for financial assets.

BC112 In developing the exposure draft, the IASB concluded that the fair value of a financial asset reflects any benefits that market participants would derive from holding that asset within a diversified portfolio. An entity derives no incremental value from holding a financial asset within a portfolio. Furthermore, the IASB noted that the valuation premise related only to assets, not to liabilities, and as such could not be applied to portfolios of financial instruments that include financial liabilities. Therefore, the exposure draft proposed that the in-exchange valuation premise must be used to measure the fair value of a financial asset. The IASB also proposed an amendment to IAS 39 making it explicit that the unit of account for financial instruments is the individual financial instrument at all levels of the fair value hierarchy (Level 1, 2 or 3).

BC113 The boards understand that although the approaches used to measure the fair value of financial assets and financial liabilities were expressed differently in IFRSs and US GAAP, they resulted in similar fair value measurement conclusions in many cases. However, the FASB was aware that before the amendments Topic 820 was sometimes interpreted more broadly than the FASB intended, such as when an entity used the in-use valuation premise to measure the fair value of a group of financial assets when the entity did not have offsetting positions in a particular market risk (or risks) or counterparty credit risk. That interpretation led the IASB to propose requiring the in-exchange valuation premise for financial assets in its exposure draft.

BC114 The IASB's proposal to require the fair value of a financial asset to be measured using the in-exchange valuation premise was one of the more controversial proposals in the exposure draft. That proposal, combined with a proposed amendment to IAS 39 about the unit of account for financial instruments, led respondents to believe that the fair value of financial assets cannot reflect the fact that those assets are held within a portfolio, even when an entity manages its financial instruments on the basis of the entity's net exposure, rather than its gross exposure, to market risks and credit risk.

BC115 Respondents were concerned that the proposal in the exposure draft would separate the valuation of financial instruments for financial reporting from the entity's internal risk management practices. In addition, they were concerned about the systems changes that would be necessary to effect a change in practice. To preserve the relationship between financial reporting and risk management, some respondents asked whether they would be able to apply the bid-ask spread guidance to each of the individual instruments so that the sum of the fair values of the individual instruments equals the value of the net position.

BC116 Other respondents suggested that the IASB should continue to allow the practice that has developed using paragraph AG72 of IAS 39, which stated:

> When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate.

BC117 The previous requirements in IFRSs and US GAAP did not clearly specify the relationship between the fair value measurement of financial instruments and how an entity manages its net risk exposure. For example, Topic 820, IAS 39 and IFRS 9 did not explicitly address how the following meet the objective of a fair value measurement for financial instruments:

(a) Entities typically do not manage their exposure to market risks and credit risk by *selling* a financial asset or transferring a financial liability (eg by unwinding a transaction). Instead, they manage their risk exposure by entering into a transaction for another financial instrument (or instruments) that would result in an offsetting position in the same risk. The resulting measurement represents the fair value of the net risk exposure, not the fair value of an individual financial instrument. The sum of the fair values of the individual instruments is not equal to the fair value of the net risk exposure.

(b) An entity's net risk exposure is a function of the other financial instruments held by the entity and of the entity's risk preferences (both of which are entity-specific decisions and, thus, do not form part of a fair value measurement). Market participants may hold different groups of financial instruments or may have different risk preferences, and it is those factors that are taken into account when measuring fair value. However, the boards understand that market participants holding that particular group of financial instruments and with those particular risk preferences would be likely to price those financial instruments similarly (ie using similar valuation techniques and similar market data). As a result, the market participants' measurement of those financial instruments within that particular group is a market-based measurement, and a measurement using an entity's risk preferences would not be a fair value measurement, but an entity-specific measurement.

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

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

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

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

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

Exposure to market risks

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

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

Exposure to the credit risk of a particular counterparty

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

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

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

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

Relationship between measurement and presentation

BC128 In some cases the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of those financial instruments. For example, that would be the case if an IFRS does not require or permit financial instruments to be presented on a net basis. The FASB's proposed ASU stated that the exception would not apply to financial statement presentation (ie an entity must comply with the financial statement presentation requirements specified in other standards).

BC129 The boards discussed the different approaches to measurement and presentation, particularly in the light of their currently differing requirements for offsetting financial assets and financial liabilities. In IAS 32 an entity may not use net presentation unless specific criteria are met, whereas in US GAAP many entities are able to use net presentation in their financial statements. However, the criteria for net presentation in US GAAP relate to credit risk, not to market risks. As a result, the presentation and measurement bases are different when an entity applies bid-ask adjustments on a net basis but is required to present fair value information on a gross basis (although generally the financial instruments with bid-ask adjustments would qualify for net presentation in US GAAP because of the existence of master netting agreements and other credit risk mitigating arrangements).

BC130 The boards concluded that a relationship between presentation and measurement is not necessary and that adjustments for market risks or credit risk (ie portfolio-level adjustments) are a matter of measurement rather than presentation. They reasoned that fair value measurements are meant to reflect (a) the risk exposure faced by the entity and (b) how that risk exposure would be priced by market participants (which is one reason the boards decided to permit the exception; see paragraph BC117). When pricing financial instruments, a market participant would take into account the other instruments it holds to the extent that those instruments reduce or enhance its overall risk exposure. That is a consequence of requiring or permitting financial instruments to be measured at fair value. The boards' considerations for requiring net or gross presentation of financial instruments are different from those for requiring net or gross measurement.

BC131 Some respondents asked for additional guidance for allocating the bid-ask and credit adjustments to the individual assets and liabilities that make up the group of financial assets and financial liabilities. Although any allocation method is inherently subjective, the boards concluded that a quantitative allocation would be appropriate if it was reasonable and consistently applied. Therefore, the boards decided not to require a particular method of allocation.

Fair value at initial recognition

BC132 The exposure draft proposed guidance for measuring fair value at initial recognition, using both observable and unobservable inputs (as appropriate). The exposure draft also proposed a list of indicators specifying when the transaction price might not be the best evidence of the fair value of an asset or a liability at initial recognition.

BC133 Respondents generally agreed with the list of indicators, but thought that the wording used implied that those were the only indicators, rather than examples of indicators. They suggested that the IFRS on fair value measurement should use the wording in US GAAP. The boards agreed with respondents that the list of indicators was not exhaustive and decided to use the wording in Topic 820.

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

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

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

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

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

Valuation techniques

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

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

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

Single versus multiple valuation techniques

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

Valuation adjustments

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

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

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

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

(b) applying the point within the bid-ask spread that is most representative of fair value in the circumstances.

(c) an adjustment to take into account non-performance risk (eg an entity's own credit risk or the credit risk of the counterparty to a transaction).

(d) an adjustment to take into account measurement uncertainty (eg when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value).

BC146 The boards decided that it would be appropriate to apply such valuation adjustments if those adjustments are consistent with the objective of a fair value measurement. Valuation adjustments may help avoid an understatement or overstatement of a fair value measurement and should be applied when a valuation technique or the inputs to a valuation technique do not capture factors that market participants would take into account when pricing an asset or a liability at the measurement date, including assumptions about risk.

Consistency constraint

BC147 IFRS 13 emphasises the need for consistency in the valuation technique or techniques used to measure fair value. It does not preclude a change in valuation technique, provided that the change results in a measurement that is equally or more representative of fair value in the circumstances. The exposure draft proposed requiring an entity to disclose the effect of a change in valuation technique on a fair value measurement (similar to the disclosures required by IAS 8 for a change in valuation technique). Respondents did not support that proposal because they thought it would be difficult to determine whether a change in fair value was attributable to a change in the valuation technique used or attributable to changes in other factors (such as changes in the observability of the inputs used in the measurement).

BC148 The IASB agreed with those respondents and decided that in the absence of an error (eg in the selection or application of a particular valuation technique), revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate in accordance with IAS 8. The IASB concluded that disclosing the effect of a change in valuation technique on the fair value measurement or requiring the disclosures in IAS 8 for a change in accounting estimate would not be cost-beneficial.

Inputs to valuation techniques

Assumptions about risk

BC149 In IFRS 13 inputs refer broadly to the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. The IASB decided that a necessary input to a valuation technique is an adjustment for risk because market participants would make such an adjustment when pricing an asset or a liability. Therefore, including an adjustment for risk ensures that the measurement reflects an exit price for the asset or liability, ie the price that would be received in an orderly transaction to sell an asset or paid in an orderly transaction to transfer the liability at the measurement date under current market conditions.

BC150 The IASB accepted that it might be difficult for an entity to quantify a risk adjustment in some cases, but concluded that this difficulty does not justify the exclusion of this input if market participants would take it into account. The exposure draft focused on the need to adjust for the risk inherent in a particular valuation technique used to measure fair value, such as a pricing model (model risk) and the risk inherent in the inputs to the valuation technique (input risk). That proposal was consistent with US GAAP.

Observable and unobservable inputs

BC151 IFRS 13 distinguishes between observable inputs and unobservable inputs, and requires an entity to maximise the use of relevant observable inputs and minimise the use of unobservable inputs (consistently with the fair value measurement guidance that was already in IFRSs). Respondents to the exposure draft expressed concerns about being required to use observable inputs during the global financial crisis that started in 2007 when the available observable inputs were not representative of the asset or liability being measured at fair value. Given that feedback, the IASB wanted to ensure that observability was not the only criterion applied when selecting the inputs to a valuation technique. Consequently, IFRS 13 focuses on *relevant* observable inputs because the IASB noted that in some cases the available observable inputs will require an entity to make significant adjustments to them given the characteristics of the asset or liability and the circumstances at the measurement date (eg market conditions).

Application of premiums and discounts in a fair value measurement

BC152 The exposure draft proposed an amendment to IAS 39 making it explicit that the unit of account for a financial instrument is the individual financial instrument at all levels of the fair value hierarchy. That proposal in effect would have prohibited the application of premiums and discounts related to the size of an entity's holding in a fair value measurement categorised within any level of the fair value hierarchy for financial instruments within the scope of IAS 39. The IASB proposed that amendment for the following reasons:

(a) The unit of account for a financial instrument should not depend on an instrument's categorisation within the fair value hierarchy.

(b) Market participants will enter into a transaction to sell a financial instrument that maximises the fair value of an asset or minimises the fair value of a liability. An entity's decision to sell at a less advantageous price because it sells an entire holding rather than each instrument individually is a factor specific to that reporting entity.

BC153 Before the amendments to Topic 820, US GAAP generally prohibited any adjustment to a quoted price in an active market for an identical asset or liability for a fair value measurement categorised within Level 1 of the fair value hierarchy (including either a blockage factor, which was described as an adjustment to a quoted price for an asset or a liability when the normal daily trading volume for the asset or liability is not sufficient to absorb the quantity held and therefore placing orders to sell the asset or liability in a single transaction might affect the quoted price, or any other premium or discount). However, Topic 820 did not specify whether a blockage factor (or another premium or discount, such as a control premium or a non-controlling interest discount) should be applied in a fair value measurement categorised within Level 2 or Level 3 of the fair value hierarchy if market participants would take it into account when pricing the asset or liability.

BC154 Respondents interpreted the proposal in the exposure draft as being consistent with Topic 820 for fair value measurements categorised within Level 1 of the fair value hierarchy, but they thought it was inconsistent with Topic 820 for fair value measurements categorised within Level 2 and Level 3. For example, some respondents thought that the IASB intended to prohibit the application of any premiums or discounts (such as a control premium) for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy even when market participants would take into account a premium or discount when pricing the asset or liability for a particular unit of account.

BC155 Some respondents supported the proposal for fair value measurements categorised within Level 1 of the fair value hierarchy even though, in their view, entities do not typically exit a position on an individual instrument basis (eg by entering into a transaction to sell a single share of equity). Those respondents understood the boards' concerns about verifiability within Level 1. Other respondents stated that the fair value measurement should reflect the fair value of the entity's *holding*, not of each individual instrument within that holding (ie they did not agree that the unit of account for a financial instrument should be a single instrument). Those respondents maintained that the principle should be that the unit of account reflects how market participants would enter into a transaction for the asset or liability. They asserted that market participants would not (and often cannot) sell individual items. The FASB received similar comments when developing SFAS 157. The boards concluded that such concerns were outside the scope of the fair value measurement project because the project addressed *how* to measure fair value and not *what* is measured at fair value.

BC156 In addition, the comments received on the exposure draft indicated that respondents had different interpretations of the term *blockage factor*. Many respondents interpreted a blockage factor as any adjustment made because of the size of an asset or a liability. In the boards' view, there is a difference between size being a characteristic of the asset or liability and size being a characteristic of the entity's holding. Accordingly, the boards clarified that a blockage factor encompasses the latter and is not relevant in a fair value measurement because a fair value measurement reflects the value of the asset or liability to a market participant for a particular unit of account and is not necessarily representative of the value of the entity's entire holding.

BC157 Given the description of a blockage factor, the boards concluded that an entity's decision to realise a blockage factor is specific to that entity, not to the asset or liability. In many cases the unit of account for a financial instrument for financial reporting is the individual financial instrument. In such cases the size of an entity's holding is not relevant in a fair value measurement. An entity would realise a blockage factor when that entity decides to enter into a transaction to sell a block consisting of a large number of identical assets or liabilities. Therefore, blockage factors are conceptually similar to transaction costs in that they will differ depending on how an entity enters into a transaction for an asset or a liability. The boards concluded that if an entity decides to enter into a transaction to sell a block, the consequences of that decision should be recognised when the decision is carried out regardless of the level of the fair value hierarchy in which the fair value measurement is categorised.

BC158 Therefore, the boards decided to clarify that the application of premiums and discounts in a fair value measurement is related to the characteristics of the asset or liability being measured at fair value and its unit of account. IFRS 13 specifies that when a Level 1 input is not available, a fair value measurement should incorporate premiums or discounts if market participants would take them into account in a transaction for the asset or liability. Paragraph BC168 describes the IASB's rationale for requiring an entity to use Level 1 inputs without adjustment whenever available. However, the boards decided to clarify that the application of premiums or discounts must be consistent with the unit of account in the IFRS that requires or permits the fair value measurement.

BC159 The boards decided not to provide detailed descriptions of premiums and discounts or to provide detailed guidance about their application in a fair value measurement. They reasoned that such descriptions and guidance would be too prescriptive because the application of premiums and discounts in a fair value measurement depends on the facts and circumstances at the measurement date. In the boards' view, different facts and circumstances might lead to particular premiums or discounts being relevant for some assets and liabilities but not for others (eg in different jurisdictions). Furthermore, the boards did not intend to preclude the use of particular premiums or discounts, except for blockage factors.

Inputs based on bid and ask prices

BC160 In some situations, inputs might be determined on the basis of bid and ask prices, eg an input from a dealer market, in which the bid price represents the price the dealer is willing to pay and the ask price represents the price at which the dealer is willing to sell. IAS 39 required the use of bid prices for asset positions and ask prices for liability positions. IAS 36 and IAS 38 *Intangible Assets* had similar requirements.

BC161 The exposure draft proposed that a fair value measurement should use the price within the bid-ask spread that is most representative of fair value in the circumstances. Furthermore, the exposure draft stated that the bid-ask spread guidance applied at all levels of the fair value hierarchy, when bid and ask prices are relevant (see paragraph BC165), and did not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient.

BC162 Many respondents supported the proposal because in their experience different market participants enter into transactions at different prices within a bid-ask spread. Some respondents preferred a single bid-ask spread pricing method, as described in IAS 39, because it would maximise the consistency and comparability of fair value measurements using bid and ask prices.

BC163 The IASB observed that, in many situations, bid and ask prices establish the boundaries within which market participants would negotiate the price in the exchange for the asset or liability. Having clarified the fair value measurement objective, the IASB concluded that an entity should use judgement in meeting that objective. Accordingly, IFRS 13 states that a fair value measurement should use the price within the bid-ask spread that is most representative of fair value in the circumstances, and that the use of bid prices for asset positions and ask prices for liability positions is permitted but is not required.

BC164 IAS 39 stated that the *bid-ask spread* includes only transaction costs. In IAS 39 other adjustments to arrive at fair value (eg for counterparty credit risk) were not included in the term *bid-ask spread*. Some respondents asked whether the proposed bid-ask guidance reflected that view. Although the boards decided not to specify what, if anything, is in a bid-ask spread besides transaction costs, in the boards' view the bid-ask spread does not include adjustments for counterparty credit risk (see paragraphs BC124–BC127 for a discussion on adjustments for counterparty credit risk when measuring fair value). Therefore, an entity will need to make an assessment of what is in the bid-ask spread for an asset or a liability when determining the point within the bid-ask spread that is most representative of fair value in the circumstances.

BC165 Some respondents noted that there could be a difference between entry prices and exit prices when entities enter into transactions at different points within the bid-ask spread. For example, an entity might buy an asset at the ask price (entry price) and measure fair value using the bid price (exit price). The boards concluded that bid-ask spreads are only relevant for financial instruments and in markets in which an intermediary (eg a broker) is necessary to bring together a buyer and a seller to engage in a transaction (ie when the buyer and seller need an intermediary to find one another). When measuring the fair value of a non-financial asset or non-financial liability, the notion of a bid-ask spread will not be relevant because the buyers and sellers in the principal (or most advantageous) market have already found one another and are assumed to have negotiated the transaction price (ie fair value).

Fair value hierarchy

BC166 IFRS 13 uses a three-level fair value hierarchy, as follows:

(a) Level 1 comprises unadjusted quoted prices in active markets for identical assets and liabilities.

(b) Level 2 comprises other observable inputs not included within Level 1 of the fair value hierarchy.

(c) Level 3 comprises unobservable inputs (including the entity's own data, which are adjusted if necessary to reflect the assumptions market participants would use in the circumstances).

BC167 The IASB noted that many IFRSs already contained an implicit fair value hierarchy by referring to observable market transactions or measuring fair value using a valuation technique. For example, the following three-level measurement hierarchy was implicit in IAS 39 and IFRS 9:

(a) financial instruments quoted in an active market;

(b) financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets; and

(c) financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument (ie without modification or repackaging) and not based on available observable market data.

Level 1 inputs

BC168 Level 1 inputs are unadjusted quoted prices in active markets for identical assets and liabilities. The IASB concluded that those prices generally provide the most reliable evidence of fair value and should be used to measure fair value whenever available.

BC169 IFRS 13 defines an active market as a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The IASB concluded that although different words are used, that definition is consistent with the definitions of an active market already in IFRSs:

(a) IASs 36, 38 and 41 stated that an active market is one in which '(i) the items traded in the market are homogeneous; (ii) willing buyers and sellers can normally be found at any time; and (iii) prices are available to the public.'

(b) IAS 39 and IFRS 9 stated that an active market is one in which 'quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.'

BC170 IFRS 13 states that when an entity holds a large number of similar assets and liabilities that are required to be measured at fair value and a quoted price in an active market is not readily accessible for each of those assets and liabilities, the entity can use an alternative pricing method that does not rely exclusively on quoted prices as a practical expedient (although the resulting fair value measurement is a lower level measurement). For example, an entity might hold a large number of similar debt instruments (such as sovereign debt securities) and use matrix pricing, which does not rely exclusively on quoted prices, to measure the fair value of those instruments. In such a situation, although a Level 1 input is used to measure fair value, the fair value measurement would not be categorised within Level 1 of the fair value hierarchy. That is a departure from the principle that a fair value measurement should maximise the use of relevant observable inputs. However, the IASB regards this particular practical expedient as justified on cost-benefit grounds.

Level 2 inputs

BC171 Level 2 inputs are all inputs other than quoted prices included in Level 1 that are observable (either directly or indirectly) for the asset or liability. The IASB concluded that it is appropriate to include in Level 2 market-corroborated inputs that might not be directly observable, but are based on or supported by observable market data, because such inputs are less subjective than unobservable inputs classified within Level 3.

Level 3 inputs

BC172 Level 3 inputs are unobservable inputs for the asset or liability.

BC173 Some respondents stated that it would be misleading to describe a measurement using significant unobservable inputs as a fair value measurement. They also expressed concerns that unobservable inputs may include entity-specific factors that market participants would not consider. Therefore, they suggested that the IASB should use a different label for measurements that use significant unobservable inputs. However, the IASB concluded that it would be more helpful to users of financial statements to use the label *fair value* for all three levels of the hierarchy described in the exposure draft, for the following reasons:

(a) The proposed definition of fair value identifies a clear objective for valuation techniques and the inputs to them: consider all factors that market participants would consider and exclude all factors that market participants would exclude. An alternative label for Level 3 measurements would be unlikely to identify such a clear objective.

(b) The distinction between Levels 2 and 3 is inevitably subjective. It is undesirable to adopt different measurement objectives on either side of such a subjective boundary.

Rather than requiring a different label for measurements derived using significant unobservable inputs, the IASB concluded that concerns about the subjectivity of those measurements are best addressed by requiring enhanced disclosure for those measurements (see paragraphs BC187–BC210).

BC174 The IASB accepts that the starting point for Level 3 inputs might be estimates developed by the entity. However, the entity must adjust those inputs if reasonably available information indicates that other market participants would use different data when pricing the asset or liability or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy).

BC175 Some respondents expressed concerns that an entity would be compelled by its auditors or regulators to undertake exhaustive efforts to obtain information about the assumptions that market participants would use when pricing the asset or liability. Furthermore, they were concerned that their judgement would be questioned when asserting the absence of contrary data. IFRS 13 states that such exhaustive efforts would not be necessary. However, when information about market participant assumptions is reasonably available, an entity cannot ignore it.

Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

BC176 The global financial crisis that started in 2007 emphasised the importance of having common fair value measurement requirements in IFRSs and US GAAP, particularly for measuring fair value when the market activity for an asset or a liability declines. As a result, and consistently with the recommendations of the Group of Twenty (G20) Leaders, the Financial Stability Board and the IASB's and FASB's Financial Crisis Advisory Group, the IASB and the FASB worked together to develop common requirements for measuring the fair value of assets and liabilities when markets are no longer active.

BC177 In May 2008 the IASB set up a Fair Value Expert Advisory Panel in response to recommendations made by the Financial Stability Forum (now the Financial Stability Board) to address the measurement and disclosure of financial instruments when markets are no longer active. The Panel's discussions were observed by FASB staff. In October 2008 the IASB staff published a staff report on the Panel's discussions.

BC178 Also in response to the global financial crisis, in April 2009 the FASB issued FASB Staff Position (FSP) No. FAS 157-4 *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. That FSP was codified in Topic 820 and provides guidance for:

(a) measuring fair value when the volume or level of activity for the asset or liability has significantly decreased; and

(b) identifying circumstances that indicate a transaction is not orderly.

BC179 IASB published a Request for Views that asked respondents whether they believed that the guidance in that FSP was consistent with the Panel's report. The IASB also asked members of the Fair Value Expert Advisory Panel the same question. The IASB received 69 responses to the Request for Views. The respondents to the Request for Views and the members of the Fair Value Expert Advisory Panel indicated that the FSP was consistent with the Panel's report. As a result, the IASB included the guidance from FSP FAS 157-4 in the exposure draft.

BC180 Respondents to the exposure draft generally agreed with the proposed guidance and found it consistent with the concepts in the IASB's Fair Value Expert Advisory Panel's report and in US GAAP. However, some respondents noted that the words used in the exposure draft were different from those used in US GAAP and wondered whether the requirements were meant to be different. The boards acknowledged those concerns and decided to align the wording. In addition, the boards decided to clarify that the requirements pertain to when there has been a significant decline in the volume or level of activity for the asset or liability, not to assets and liabilities for which there is typically no observable market.

BC181 Furthermore, the boards concluded that when applying IFRS 13 and Topic 820 an entity should focus on whether an observed transaction price is the result of an orderly transaction, not only on the level of activity in a market, because even in a market with little activity, transactions can be orderly. Accordingly, the boards concluded that an entity should consider observable transaction prices unless there is evidence that the transaction is not orderly. If an entity does not have sufficient information to determine whether a transaction is orderly, it performs further analysis to measure fair value.

BC182 Also as a result of the global financial crisis, there was a particularly urgent need to improve transparency of fair value measurements for financial instruments. To address that need, the IASB amended IFRS 7 *Financial Instruments: Disclosures* in March 2009. The amended disclosures about fair value measurements have been relocated to IFRS 13.

Disclosure

BC183 The disclosures about fair value measurements in IFRSs vary, although many require, at a minimum, information about the methods and significant assumptions used in the measurement, and whether fair value was measured using observable prices from recent market transactions for the same or a similar asset or liability.

BC184 The IASB decided that having established a framework for measuring fair value, it should also enhance and harmonise the disclosures about fair value measurements. The IASB decided to limit the disclosures to fair values measured in the statement of financial position after initial recognition, whether those measurements are made on a recurring or non-recurring basis, because other IFRSs address the disclosure of fair values at initial recognition (eg IFRS 3 requires disclosure of the measurement of assets acquired and liabilities assumed in a business combination).

BC185 The objective of the disclosures in IFRS 13 is to provide users of financial statements with information about the valuation techniques and inputs used to develop fair value measurements and how fair value measurements using significant unobservable inputs affected profit or loss or other comprehensive income for the period. To meet those objectives, the disclosure framework (a) combines the disclosures currently required by IFRSs and US GAAP and (b) provides additional disclosures that users of financial statements suggested would be helpful in their analyses. In developing the disclosures, the IASB used information received from users and preparers of financial statements and the IASB's Fair Value Expert Advisory Panel.

Distinguishing between recurring and non-recurring fair value measurements

BC186 The disclosures in US GAAP differentiate fair value measurements that are recurring from those that are non-recurring. The exposure draft did not propose differentiating recurring from non-recurring fair value measurements and required the same information about all fair value measurements. However, users of financial statements asked the IASB to include the same principles for disclosing information about fair value measurements in IFRSs that are in US GAAP. As a result, the boards decided to differentiate the two types of fair value measurements and to describe their differences.

Information about fair value measurements categorised within Level 3 of the fair value hierarchy

BC187 The boards received requests from users of financial statements for more information about fair value measurements categorised within Level 3 of the fair value hierarchy. The following sections describe the boards' response to those requests.

Quantitative information

BC188 The exposure draft proposed requiring an entity to disclose the methods and inputs used in a fair value measurement, including the information used to develop those inputs. That proposal was developed using feedback from users of financial statements and the IASB's Fair Value Expert Advisory Panel. Although the proposal was not explicit, the IASB intended that the information about the inputs used in the measurement would be quantitative.

BC189 Before the amendments to Topic 820, US GAAP required an entity to provide a description of the inputs used when measuring the fair value of an asset or a liability that is categorised within Level 2 or Level 3 of the fair value hierarchy. Topic 820 was not explicit about whether that description needed to include quantitative information.

BC190 Users of financial statements asked the boards to clarify that entities must provide quantitative information about the inputs used in a fair value measurement, particularly information about unobservable inputs used in a measurement categorised within Level 3 of the fair value hierarchy. When limited or no information is publicly available, disclosures about such information help users to understand the measurement uncertainty inherent in the fair value measurement.

BC191 Therefore, the boards decided to clarify that an entity should disclose *quantitative* information about the significant unobservable inputs used in a fair value measurement categorised within Level 3 of the fair value hierarchy.

BC192 Some respondents to the FASB's proposed ASU questioned the usefulness of quantitative information about the unobservable inputs used in a fair value measurement because of the level of aggregation required in those disclosures. The boards noted that the objective of the disclosure is not to enable users of financial statements to replicate the entity's pricing models, but to provide enough information for users to assess whether the entity's views about individual inputs differed from their own and, if so, to decide how to incorporate the entity's fair value measurement in their decisions. The boards concluded that the information required by the disclosure will facilitate comparison of the inputs used over time, providing users with information about changes in management's views about particular unobservable inputs and about changes in the market for the assets and liabilities within a particular class. In addition, that disclosure might facilitate comparison between entities with similar assets and liabilities categorised within Level 3 of the fair value hierarchy.

BC193 IFRS 13 and Topic 820 state that an entity should determine appropriate classes of assets and liabilities on the basis of the nature, characteristics and risks of the assets and liabilities, noting that further disaggregation might be required for fair value measurements categorised within Level 3 of the fair value hierarchy. Consequently, the boards concluded that the meaningfulness of the disclosure of quantitative information used in Level 3 fair value measurements will depend on an entity's determination of its asset and liability classes.

BC194 Some respondents to the IASB's re-exposure document and the FASB's proposed ASU suggested requiring quantitative information about the unobservable inputs used in fair value measurements categorised within Level 2 of the fair value hierarchy because determining whether to categorise fair value measurements within Level 2 or Level 3 can be subjective. The boards concluded that for a fair value measurement to be categorised within Level 2 of the fair value hierarchy, the unobservable inputs used, if any, must not be significant to the measurement in its entirety. As a result, the boards decided that quantitative information about unobservable inputs would be of limited use for those measurements.

BC195 In addition, the boards understand that fair value is sometimes measured on the basis of prices in prior transactions (eg adjustments to the last round of financing for a venture capital investment) or third-party pricing information (eg broker quotes). Such measurements might be categorised within Level 3 of the fair value hierarchy. In such cases, the boards concluded that an entity should be required to disclose how it has measured the fair value of the asset or liability, but that it should not need to create quantitative information (eg an implied market multiple or future cash flows) to comply with the disclosure requirement if quantitative information other than the prior transaction price or third-party pricing information is not used when measuring fair value. However, the boards concluded that when using a prior transaction price or third-party pricing information, an entity cannot ignore other quantitative information that is reasonably available. If there was an adjustment to the price in a prior transaction or third-party pricing information that is significant to the fair value measurement in its entirety, that adjustment would be an unobservable input about which the entity would disclose quantitative information even if the entity does not disclose the unobservable information used when pricing the prior transaction or developing the third-party pricing information.

Level 3 reconciliation for recurring fair value measurements

BC196 The exposure draft proposed requiring an entity to provide a reconciliation from the opening balances to the closing balances of fair value measurements categorised within Level 3 of the fair value hierarchy. IFRS 7 required such a disclosure for financial instruments after it was amended in March 2009 to introduce a three-level fair value hierarchy, and to require more detailed information about fair value measurements categorised within Level 3 of the fair value hierarchy. In addition, many IFRSs already required a similar reconciliation for all fair value measurements, not only for those that are categorised within Level 3 of the fair value hierarchy.

BC197 Some respondents agreed with the proposed reconciliation disclosure because they thought it would help meet the objective to provide meaningful information to users of financial statements about the relative subjectivity of fair value measurements. Other respondents thought that the disclosure requirement would be onerous and did not believe that the benefits would outweigh the costs, particularly for non-financial assets and liabilities. The IASB received similar feedback on the proposed amendments to IFRS 7. However, users of financial statements told the IASB that the disclosures made in accordance with US GAAP and IFRS 7 were helpful, particularly in the light of the global financial crisis that started in 2007. They indicated that the disclosures allowed them to make more informed judgements and to segregate the effects of fair value measurements that are inherently subjective, thereby enhancing their ability to assess the quality of an entity's reported earnings. Consequently, the IASB decided to require an entity to provide such a reconciliation.

BC198 The exposure draft and IFRS 7 did not distinguish between *realised* and *unrealised* gains or losses. That was because those documents referred to *gains or losses attributable to assets and liabilities held at the end of the reporting period*, which the IASB meant to be equivalent to *unrealised* gains or losses (ie realised gains or losses result from the sale, disposal or settlement of an asset or a liability, and therefore the asset or liability is no longer held by the entity at the reporting date, whereas unrealised gains or losses relate to changes in the fair value of an asset or a liability that is held by the entity at the reporting date). Respondents to the exposure draft wondered whether the different terminology used in the exposure draft and in Topic 820 meant that the disclosure proposed for IFRSs would be different from the disclosure required by US GAAP. To ensure that there would be no differences in interpretation of the requirements in IFRSs and US GAAP, the IASB decided to use the terms *realised* and *unrealised* in the reconciliation disclosure.

BC199 The IASB concluded that the disclosure should focus on recurring fair value measurements because it would be difficult to reconcile the opening balances to the closing balances for non-recurring fair value measurements when the carrying amount of an asset or a liability is not determined on the basis of fair value at each reporting period. For example, it would be difficult to reconcile changes in fair value when an asset held for sale is recognised at its carrying amount in accordance with IFRS 5 in one period and at fair value less costs to sell in the next period. The information gained from requiring a reconciliation of changes in fair value from one period to the next is not available when requiring changes resulting from the use of different measurement bases from one period to the next.

Valuation processes

BC200 The boards decided to require an entity to disclose the valuation processes used for fair value measurements categorised within Level 3 of the fair value hierarchy (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period). They made that decision because users of financial statements told the boards that information about an entity's valuation processes helps them assess the relative subjectivity of the entity's fair value measurements, particularly for those categorised within Level 3 of the fair value hierarchy.

BC201 In addition, the requirements in IFRS 13 are consistent with the conclusions of the IASB's Fair Value Expert Advisory Panel as described in its report in October 2008.

Sensitivity to changes in unobservable inputs

BC202 The exposure draft proposed requiring a quantitative sensitivity analysis for fair value measurements categorised within Level 3 of the fair value hierarchy. That proposal was taken from the requirement in IFRS 7 to disclose a sensitivity analysis if changing any of the unobservable inputs used in the measurement to reasonably possible alternative assumptions would change the fair value significantly. Although in IFRS 7 that disclosure was required for financial assets and financial liabilities measured at fair value, under the proposal it would have been required for all assets and liabilities measured at fair value.

BC203 In August 2009 the FASB proposed a similar disclosure requirement in its proposed ASU *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*, although that proposal would have required an entity to take into account the effect of interrelationships between inputs. Very few respondents to that proposed ASU supported the proposed disclosure, stating that it would not provide useful information and would be costly and operationally challenging. However, users were supportive of the proposed disclosure. The FASB decided to defer the consideration of a sensitivity analysis disclosure requirement to the joint fair value measurement project.

BC204 In the boards' discussions about that sensitivity analysis disclosure, they considered whether the IASB's proposed disclosure and that in IFRS 7 would be improved if the boards required an entity to include the effect of interrelationships between unobservable inputs, thereby showing a range of fair values (exit prices) that reasonably could have been measured in the circumstances as of the measurement date. Because that refinement of the disclosure was not included in the IASB's May 2009 exposure draft and was not required by IFRS 7, the IASB needed to expose the proposal to require the sensitivity analysis including the effect of interrelationships between unobservable inputs. That disclosure was referred to in the IASB's re-exposure document and the FASB's proposed ASU in June 2010 as a *measurement uncertainty analysis disclosure*.

BC205 Respondents to the FASB's proposed ASU and the IASB's re-exposure document were concerned about whether the proposal would be operational (those comments were consistent with those received on the FASB's proposed ASU in August 2009). Although that proposal was in response to requests from users of financial statements to require additional information about the measurement uncertainty inherent in fair value measurements (particularly those categorised within Level 3 of the fair value hierarchy), the responses from preparers of financial statements indicated that the costs associated with preparing such a disclosure would outweigh the benefits to users once the information had been aggregated by class of asset or liability. As an alternative to the proposal, those respondents suggested that the boards should require a qualitative assessment of the subjectivity of fair value measurements categorised within Level 3 of the fair value hierarchy, as well as an alternative quantitative approach that would be less costly to prepare (see paragraphs BC188–BC195).

BC206 Therefore, the boards decided to require an entity to provide a narrative description, by class of asset or liability, of the sensitivity of a recurring fair value measurement categorised within Level 3 of the fair value hierarchy to changes in the unobservable inputs used in the measurement if a change in those inputs to a different amount would result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs, the boards decided to require an entity to provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. The boards concluded that such information would provide users of financial statements with information about how the selection of unobservable inputs affects the valuation of a particular class of assets or liabilities. The boards expect that the narrative description will focus on the unobservable inputs for which quantitative information is disclosed because those are the unobservable inputs that the entity has determined are most significant to the fair value measurement. They will continue to assess whether a quantitative measurement uncertainty analysis disclosure would be practical after issuing IFRS 13, with the aim of reaching a conclusion about whether to require such a disclosure at a later date.

BC207 The boards concluded that a narrative description about sensitivity provides users of financial statements with information about the directional effect of a change in a significant unobservable input on a fair value measurement. That disclosure, coupled with quantitative information about the inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy, provides information for users to assess whether the entity's views about individual inputs differed from their own and, if so, to decide how to incorporate the entity's fair value measurement in their decisions. In addition, that disclosure provides information about the pricing model for those users who are not familiar with the valuation of a particular class of assets or liabilities (eg complex financial instruments).

BC208 In addition to the narrative sensitivity analysis disclosure, IFRS 13 requires a quantitative sensitivity analysis for financial instruments that are measured at fair value and categorised within Level 3 of the fair value hierarchy (ie the disclosure that was previously in IFRS 7). The IASB decided to move that requirement from IFRS 7 to IFRS 13 so that all the fair value measurement disclosure requirements in IFRSs are in a single location. When developing IFRS 7, the IASB concluded that information about the sensitivities of fair value measurements to the main valuation assumptions would provide users of financial statements with a sense of the potential variability of the measurement. In forming that conclusion, the IASB considered the view that disclosure of sensitivities could be difficult, particularly when there are many assumptions to which the disclosure would apply and those assumptions are interdependent. However, the IASB noted that a detailed quantitative disclosure of sensitivity to all assumptions is not required (only those that could result in a significantly different estimate of fair value are required) and that the disclosure does not require the entity to reflect interdependencies between assumptions when making the disclosure.

BC209 The boards concluded that the objective of the narrative and quantitative sensitivity analysis disclosures about fair value are different from the objectives of other disclosures that an entity may be required to make in IFRSs and US GAAP, such as the market risk sensitivity analysis disclosure required by IFRS 7 (see paragraph 40 of IFRS 7). The IASB concluded that even though there is some overlap in those disclosures, the objective of each disclosure is different: the market risk sensitivity analysis disclosure in IFRS 7 provides information about an entity's exposure to future changes in market risks (ie currency risk, interest rate risk and other price risk), whereas the fair value measurement disclosures provide information about the sensitivity of the fair value measurement at the measurement date to changes in unobservable inputs for those fair value measurements with the greatest level of subjectivity (ie fair value measurements categorised within Level 3 of the fair value hierarchy). In addition, the market risk sensitivity analysis disclosure in IFRS 7 relates only to financial instruments (as does the quantitative sensitivity analysis disclosure in IFRS 13), whereas the narrative sensitivity analysis disclosure in IFRS 13 relates to all assets and liabilities measured at fair value.

BC210 The IASB identified the following differences between the market risk and fair value sensitivity analysis disclosures:

(a) The market risk disclosure is not specific to financial instruments measured at fair value, but also relates to financial instruments measured at amortised cost.

(b) The market risk disclosure focuses on the effect on profit or loss and equity, not specifically on the change in value.

(c) The market risk disclosure focuses only on the entity's exposure to market risks (ie interest rate risk, currency risk or other price risk), whereas the fair value disclosures take into account the effect on a fair value measurement of changes in significant unobservable inputs.

(d) The market risk disclosure does not distinguish between observable and unobservable inputs (or level in the fair value hierarchy, ie Level 1, 2 or 3), whereas the fair value disclosures relate only to the unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy.

Transfers between Levels 1 and 2 of the fair value hierarchy

BC211 The exposure draft proposed requiring an entity to disclose the amounts of *significant* transfers into or out of Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. That disclosure was also required in Topic 820. In their discussions, the boards decided instead to require a disclosure of *any* transfers into or out of Levels 1 and 2. Respondents to the FASB's proposed ASU generally did not support that proposal because it would require an entity to monitor all transfers on a daily basis, regardless of whether those transfers were significant. In addition, respondents were concerned about the accuracy of information about all transfers because there can be an unclear distinction between less active Level 1 fair value measurements and more active Level 2 fair value measurements.

BC212 The boards concluded that the objective of the disclosure is to provide information that will help users of financial statements assess changes in market and trading activity (the entity's or others') so that users can (a) incorporate into their analyses the entity's future liquidity risk and (b) analyse the entity's exposure to the relative subjectivity of its fair value measurements. In the boards' view, the only way to provide that information, and to reduce the subjectivity involved in preparing the information, is to require information about *all* transfers between Level 1 and Level 2 of the fair value hierarchy.

When an entity uses a non-financial asset in a way that differs from its highest and best use

BC213 The boards decided to require an entity to disclose information about when it uses a non-financial asset in a way that differs from its highest and best use (when that asset is measured at fair value in the statement of financial position or when its fair value is disclosed). The boards concluded that such a disclosure provides useful information for users of financial statements that rely on fair value information when forecasting future cash flows, whether that fair value information is presented in the statement of financial position or is disclosed in the notes. Users told the boards that they would need to know how non-financial assets are being used and how that use fits with an entity's strategic and operating plans.

BC214 The boards considered whether to limit the disclosure to some non-financial assets and not others. The boards concluded that because the measurement and disclosure requirements are principle-based, those requirements should not need to be amended in the future if the boards should decide to use fair value as the measurement basis for particular assets or liabilities. Therefore, the disclosure is required for any non-financial asset measured at fair value that an entity uses in a way that differs from its highest and best use.

The categorisation within the level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position

BC215 IFRS 7 requires an entity to disclose the fair value of financial instruments even if they are not measured at fair value in the statement of financial position. An example is a financial instrument that is measured at amortised cost in the statement of financial position.

BC216 The boards decided to require an entity to disclose the level of the fair value hierarchy in which an asset or a liability (financial or non-financial) would be categorised if that asset or liability had been measured at fair value in the statement of financial position. The boards concluded that such a disclosure would provide meaningful information about the relative subjectivity of that fair value measurement.

BC217 Respondents to the IASB's exposure draft and the FASB's proposed ASU were concerned about the cost associated with preparing that disclosure because it is not always clear in which level a fair value measurement would be categorised. The boards concluded that even if determining the level in which to categorise a fair value measurement requires judgement, the benefits of doing so outweigh the costs. Therefore, the boards decided to require an entity to disclose the level of the fair value hierarchy in which an asset or a liability would be categorised if that asset or liability had been measured at fair value in the statement of financial position.

Assets with a recoverable amount that is fair value less costs of disposal

BC218 Because IAS 36 requires disclosures that are specific to impaired assets, the exposure draft did not propose requiring the disclosures about fair value measurements for assets with a recoverable amount that is fair value less costs of disposal in IAS 36. Some respondents (mainly users of financial statements) noted that the disclosures about impaired assets are different in IFRSs and in US GAAP (which requires assets to be tested for impairment by comparing their carrying amounts with their fair values) and asked the IASB to minimise those differences to ensure that users have access to similar information for their analyses of impaired assets.

BC219 The IASB noted that the disclosure requirements in IAS 36 were developed specifically to ensure consistency in the disclosure of information about impaired assets so that the same type of information is provided whether the recoverable amount was determined on the basis of value in use or fair value less costs of disposal. Consequently, the IASB did not think it would be appropriate to require an entity to provide information when the recoverable amount is determined on the basis of fair value less costs of disposal (ie as required by IFRS 13) that is significantly different from what the entity would provide when the recoverable amount is determined on the basis of value in use.

BC220 Although IFRSs and US GAAP have different impairment models, the IASB concluded that requiring the following information (in addition to what IAS 36 currently requires) about impaired assets measured at fair value less costs of disposal would improve comparability between entities applying IFRSs and those applying US GAAP as well as increase the convergence of IFRSs and US GAAP:

(a) the fair value less costs of disposal;

(b) the level of the fair value hierarchy within which the fair value less costs of disposal is categorised in its entirety (Level 1, 2 or 3);

(c) if applicable, changes to valuation techniques and reasons for those changes; and

(d) quantitative information about significant inputs used when measuring fair value less costs of disposal (along with a conforming amendment to the disclosures about value in use).

BC221 In addition, those disclosures are consistent with the disclosures required for non-recurring fair value measurements in IFRS 13 and in US GAAP.

Interim financial reporting

BC222 For financial instruments, the exposure draft proposed that particular fair value disclosures required in annual financial statements would also be required for interim financial reports. That differed from the approach proposed for non-financial assets and non-financial liabilities, for which there is no specific fair value disclosure requirement beyond the existing requirements in IAS 34 *Interim Financial Reporting*.

BC223 Respondents generally thought that the principle underlying IAS 34 addresses when disclosures should be updated in interim financial reports. Some respondents thought the costs of providing updated information outweighed the benefits to users of financial statements of having that information.

BC224 The IASB decided to include in IAS 34 an explicit requirement to provide updated disclosures because it concluded that the benefit of having incremental disclosures for financial instruments outweighed the associated costs given the increased interest in those instruments during the global financial crisis that started in 2007.

Effective date and transition

BC225 When deciding the effective date for IFRS 13, the IASB considered the comments received on the Request for Views *Effective Date and Transition Methods*. Many respondents said that the effective date should allow enough time for them to put the necessary systems in place to ensure that their accounting policies and models meet the requirements of IFRS 13. Some of those respondents, particularly those with many assets and liabilities measured at fair value, requested a later effective date. Other respondents requested an earlier effective date, mainly for comparability reasons and because in their view many entities might have inadvertently already started applying the revised concepts.

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

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

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

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

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

Application in emerging and transition economies

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

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

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

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

(d) Models, inputs and assumptions may be new and may not be comparable across entities because of rapidly developing socio-economic changes.

(e) Measuring fair value (and preparing the resulting disclosures) could be expensive.

BC232 The IASB noted that because fair value is used in many IFRSs, knowledge about its application is necessary for applying IFRSs generally and noted that the concerns raised are not specific to entities in emerging and transition economies. Entities in developed economies faced similar challenges during the global financial crisis that started in 2007 and asked the IASB for guidance for measuring the fair value of equity instruments without active markets given the requirement to recognise them at fair value in IFRS 9. Furthermore, the IASB concluded that there should not be a different threshold for measuring fair value depending on jurisdiction. Only by performing fair value measurements will entities applying IFRSs learn how to do those measurements appropriately and robustly.

BC233 Therefore, the IASB concluded that entities applying IFRSs would benefit from educational material to accompany IFRS 13. The IFRS Foundation sometimes publishes educational material that is leveraged from the standard-setting process to reinforce the goal of promoting the adoption and consistent application of a single set of high quality international accounting standards. The IASB asked the staff to develop educational material on fair value measurement that describes at a high level the thought process for measuring assets, liabilities and an entity's own equity instruments at fair value consistent with the objective of a fair value measurement.

BC234 The IASB concluded that any educational material developed must benefit all entities equally. Thus, the educational material cannot benefit entities in emerging and transition economies without being made available to entities in developed economies.

BC235 The IASB staff and the FASB staff will liaise during the development of the educational material.

Convergence with US GAAP

BC236 As noted above, the fair value measurement project was a joint project with the FASB. The boards worked together to ensure that fair value has the same meaning in IFRSs and in US GAAP and that their respective fair value measurement and disclosure requirements are the same (except for minor differences in wording and style).

BC237 The boards worked together to ensure that, to the extent possible, IFRS 13 and Topic 820 are identical. The following style differences remain:

(a) There are differences in references to other IFRSs and US GAAP—For example, regarding related party transactions, IFRS 13 refers to IAS 24 *Related Party Disclosures* and Topic 820 refers to Topic 850 *Related Party Disclosures*.

(b) There are differences in style—For example, IFRS 13 refers to *an entity* and Topic 820 refers to *a reporting entity*.

(c) There are differences in spelling—For example, IFRS 13 refers to *labour costs* and Topic 820 refers to *labor costs*.

(d) There are differences in whether references are to a particular jurisdiction or are generic—For example, IFRS 13 refers to *risk-free government securities* and Topic 820 refers to *US Treasury securities*.

The boards concluded that those differences will not result in inconsistent interpretations in practice by entities applying IFRSs or US GAAP.

BC238 In addition, IFRS 13 and Topic 820 have the following differences:

(a) There are different accounting requirements in IFRSs and US GAAP for measuring the fair value of investments in investment companies. Topic 946 *Financial Services—Investment Companies* in US GAAP requires an investment company to recognise its underlying investments at fair value at each reporting period. Topic 820 provides a practical expedient that permits an entity with an investment in an investment company to use as a measure of fair value in specific circumstances the reported net asset value without adjustment. IFRS 10 *Consolidated Financial Statements* requires an investment company to consolidate its controlled underlying investments. Because IFRSs do not have accounting requirements that are specific to investment companies, the IASB decided that it would be difficult to identify when such a practical expedient could be applied given the different practices for calculating net asset values in jurisdictions around the world. For example, investment companies may report in accordance with national GAAP, which may have recognition and measurement requirements that differ from those in IFRSs (ie the underlying investments might not be measured at fair value, or they might be measured at fair value in accordance with national GAAP, not IFRSs). The boards are reviewing the accounting for investment companies as part of a separate project.

(b) There are different requirements for measuring the fair value of a financial liability with a demand feature. In US GAAP, Topic 825 *Financial Instruments* and Topic 942 *Financial Services—Depository and Lending* describe the fair value measurement of a deposit liability as the amount payable on demand at the reporting date. In IFRSs, IFRS 13 states that the fair value measurement of a financial liability with a demand feature (eg demand deposits) cannot be less than the present value of the amount payable on demand. That requirement in IFRS 13 was relocated unchanged from IAS 39 and IFRS 9 as a consequence of the IASB's fair value measurement project.

(c) There are different disclosure requirements in IFRSs and US GAAP. For example:

   (i) Because IFRSs generally do not allow net presentation for derivatives, the amounts disclosed for fair value measurements categorised within Level 3 of the fair value hierarchy might differ. The boards are reviewing the presentation requirements for offsetting financial assets and financial liabilities in their joint project on the accounting for financial instruments.

   (ii) IFRSs require a quantitative sensitivity analysis for financial instruments that are measured at fair value and categorised within Level 3 of the fair value hierarchy (that disclosure was previously in IFRS 7). The boards will analyse the feasibility of incorporating information about interrelationships between unobservable inputs into a quantitative measurement uncertainty analysis disclosure. After completing that analysis, the boards will decide whether to require such a disclosure.

(iii) Topic 820 has different disclosure requirements for non-public entities. The FASB concluded that some of the disclosures should not be required for non-public entities because of the characteristics of the users of the financial statements of those entities. The FASB considered the ability of those users to access information about the financial position of the entity and the relevance to those users of the information that would be provided by the requirements in the disclosure amendments. In contrast, the IASB recently completed a project on the accounting for small and medium-sized entities. As a result, the *IFRS for Small and Medium-Sized Entities* addresses the accounting for entities that do not have public accountability, and the disclosures about their fair value measurements.

Cost-benefit considerations

BC239 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. To meet that objective, the IASB seeks to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs to implement a new standard might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC240 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the IASB considers the following:

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

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

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

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

BC241 IFRS 13 defines fair value, provides a framework for measuring fair value and requires disclosures about fair value measurements. A clear definition of fair value, together with a framework for measuring fair value that eliminates inconsistencies across IFRSs that have contributed to diversity in practice, should improve consistency in application, thereby enhancing the comparability of information reported in financial statements.

BC242 The disclosures about fair value measurements would increase transparency and improve the quality of information provided to users of financial statements. In developing the disclosure requirements in IFRS 13, the IASB obtained input from users and preparers of financial statements and other interested parties to enable the IASB to assess whether the disclosures could be provided within reasonable cost-benefit constraints.

BC243 Although the framework for measuring fair value builds on current practice and requirements, some methods in IFRS 13 may result in a change to practice for some entities. Furthermore, some entities will need to make systems and operational changes, thereby incurring incremental costs. Other entities also might incur incremental costs in applying the measurement and disclosure requirements. However, the IASB concluded that the benefits resulting from increased consistency in application of fair value measurement requirements and enhanced comparability of fair value information and improved communication of that information to users of financial statements will continue. On balance, the IASB concluded that improvements in financial reporting resulting from the application of the requirements in IFRS 13 will exceed the increased costs of applying the requirements.

Summary of main changes from the exposure draft

BC244 The main changes from the proposals in the exposure draft published in May 2009 are as follows:

(a) IFRS 13 excludes from its scope share-based payment transactions in IFRS 2 and leasing transactions in IAS 17. The exposure draft proposed the following:

   (i) replacing the term *fair value* with another term that reflects the measurement objective for share-based payment transactions in IFRS 2 and for reacquired rights in a business combination in IFRS 3.

   (ii) excluding financial liabilities with a demand feature in IAS 39 from the scope of an IFRS on fair value measurement.

   The exposure draft did not propose excluding leasing transactions from the scope of an IFRS on fair value measurement.

(b) IFRS 13 requires fair value to be measured using the price in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability. The exposure draft proposed that fair value should be measured using the price in the most advantageous market.

(c) IFRS 13 states that market participants have a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary. The exposure draft stated that market participants are presumed to be as knowledgeable as the entity about the asset or liability (ie there was no information asymmetry between market participants and the entity).

(d) IFRS 13 contains detailed guidance for measuring the fair value of liabilities, including the compensation market participants would require to assume the liability and how a third-party credit enhancement affects the fair value of a liability. The exposure draft provided high level guidance.

(e) IFRS 13 contains detailed guidance for measuring the fair value of an entity's own equity instruments. That guidance is consistent with the guidance for measuring the fair value of a liability. The exposure draft proposed requiring an entity to measure the fair value of its own equity instruments by reference to the fair value of the instrument held by a market participant as an asset (ie the corresponding asset) without providing information about when the fair value of the equity instrument might differ from the fair value of the corresponding asset.

(f) IFRS 13 provides guidance for measuring the fair value of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk. The exposure draft proposed requiring financial assets to be measured using an in-exchange valuation premise.

(g) IFRS 13 states that classes of asset or liability for disclosure purposes should be determined on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy within which the fair value measurement is categorised. The exposure draft did not provide guidance for determining the appropriate class of asset or liability for disclosures about fair value measurements.

(h) IFRS 13 provides examples of policies for when to recognise transfers between levels of the fair value hierarchy, such as the date of the transfer, the beginning of the reporting period or the end of the reporting period. IFRS 13 also states that the policy about the timing of recognising transfers must be the same for transfers into a level as that for transfers out of a level. The exposure draft did not provide guidance for determining when transfers are deemed to have occurred or propose to require an entity to disclose its policy for determining when transfers between levels are recognised.

(i) IFRS 13 requires a narrative discussion of the sensitivity of a fair value measurement categorised within Level 3 of the fair value hierarchy to changes in significant unobservable inputs and any interrelationships between those inputs that might magnify or mitigate the effect on the measurement. It also requires a quantitative sensitivity analysis for financial instruments categorised within Level 3 of the fair value hierarchy (that disclosure was relocated from IFRS 7). The exposure draft proposed a quantitative sensitivity analysis for assets and liabilities categorised within Level 3 of the fair value hierarchy. The IASB re-exposed that proposal, including a requirement to take into account the interrelationships between unobservable inputs in the analysis (referred to as a measurement uncertainty analysis disclosure). Respondents were concerned about whether the proposal would be operational. The boards will continue to assess whether a quantitative measurement uncertainty analysis disclosure would be practical after the IFRS is issued, with the aim of reaching a conclusion about whether to require such a disclosure at a later date.

(j) IFRS 13 requires an entity to disclose information about its valuation processes (eg valuation policies and procedures) for fair value measurements categorised within Level 3 of the fair value hierarchy. The disclosure is similar to the description of valuation processes in the IASB's Fair Value Expert Advisory Panel's October 2008 report.

(k) If the highest and best use of a non-financial asset differs from its current use, IFRS 13 requires an entity to disclose that fact and why the asset is being used in a manner that differs from its highest and best use. The exposure draft proposed requiring an entity to disclose the value of the asset assuming its current use, the amount by which the fair value of the asset differs from its fair value in its current use (ie the incremental value of the asset group) and the reasons the asset is being used in a manner that differs from its highest and best use.

Appendix
Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 13 and the related amendments to other IFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

BCA1 In paragraph BC37(a) the first reference to 'fair value' is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

IFRS 3 *Business Combinations*

BCA2 In paragraph BC197 'the definition of fair value' is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA3 The heading above paragraph BC246 is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value.

BCA4 Paragraph BC246 is footnoted as follows:

* IFRS 13, issued in May 2011, is the result of the IASB's and the FASB's joint project on fair value measurement. As a result, the definition of fair value in IFRSs is identical to the definition in US GAAP (Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*® codified SFAS 157).

BCA5 Paragraph BC262 is footnoted as follows:

* IFRS 13, issued in May 2011, describes the concept of highest and best use and provides examples of its application in a business combination.

BCA6 In paragraph BC306 'the definitions of fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and describes the effect that transaction costs have on a fair value measurement.

BCA7 Paragraph BC336 is footnoted as follows:

* The combination of IFRS 3 and IFRS 13, issued in May 2011, provides guidance for measuring the fair value of an acquirer's interest in the acquiree (including mutual entities).

BCA8 In paragraph BC422 the second sentence is footnoted as follows:

* IFRS 13, issued in May 2011, requires disclosures about fair value measurements after initial recognition. Although the disclosures required by IFRS 13 are not required for IFRS 3, the wording has been aligned.

IFRS 4 *Insurance Contracts*

BCA9 In paragraph BC6(c) 'the definition of fair value' is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA10 The footnote to paragraph BC7 is amended as follows:

* The Board completed the second phase of its project on business combinations in 2008 by issuing a revised IFRS 3 *Business Combinations* and an amended version of IAS 27 *Consolidated and Separate Financial Statements*. <u>IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.</u>

BCA11 In paragraph BC153 'how fair value should be defined and determined' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA12 Paragraph BC185(f) is footnoted as follows:

* IFRS 13, issued in May 2011, states that the fair value of a liability reflects the effect of non-performance risk, which includes, but may not be limited to, an entity's own credit risk.

BCA13 In paragraph BC225(a) 'how to determine fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

BCA14 In paragraph BC13 the footnote to 'IAS 41 *Agriculture*' is amended as follows:

* In *Improvements to IFRSs* issued in May 2008 the Board amended IAS 41: the term 'estimated point-of-sale costs' was replaced by 'costs to sell'. <u>IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.</u>

BCA15 Paragraph BC80(b) is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

IFRS 7 *Financial Instruments: Disclosures*

BCA16 The heading above paragraph BC36 is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence paragraphs 27–27B of IFRS 7 have been deleted.

BCA17 In paragraph BC37 'unquoted equity instruments' is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 and IFRS 9 refer to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

BCA18 In paragraph BC37 'fair value cannot be measured reliably' is footnoted as follows:

* IFRS 9, issued in November 2009, amended the measurement requirements for investments in equity instruments.

BCA19 The first sentence of paragraph BC38 is footnoted as follows:

* IFRS 13, issued in May 2011, resulted in paragraph 27B(e) of IFRS 7 being deleted.

BCA20 Paragraph BC39A is footnoted as follows:

* IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures.

BCA21 Paragraph BC39B is footnoted as follows:

* IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures. That hierarchy is identical to the hierarchy in Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification®*, which codified SFAS 157.

BCA22 In paragraph BC39C 'IAS 39' is footnoted as follows:

* IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures.

BCA23 Paragraph BC39D is footnoted as follows:

* IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a result paragraphs AG71–AG73 and paragraph AG76A of IAS 39 have been deleted. In addition, the requirements in paragraph AG76A have been relocated to paragraph AG76(b).

BCA24 In paragraph BC39F the first sentence is footnoted as follows:

* IFRS 13, issued in May 2011, requires disclosures about fair value measurements. As a consequence paragraphs 27–27B of IFRS 7 have been deleted.

BCA25 Paragraph BC39G is footnoted as follows:

* IFRS 13, issued in May 2011, resulted in paragraph 27 of IFRS 7 being deleted.

IFRS 9 *Financial Instruments* (issued November 2009)

BCA26 In paragraph BC17 'the fair value hierarchy' is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value and for disclosing information about fair value measurements. IFRS 13 contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures. As a consequence paragraph 27A of IFRS 7 has been deleted.

BCA27 In paragraph BC18 'IFRS 7' is footnoted as follows:

* IFRS 13, issued in May 2011, requires disclosures about fair value measurements. As a consequence paragraph 27B(c) and (d) of IFRS 7 has been deleted.

BCA28 In the heading above paragraph BC75 and in paragraph BC79(b) 'unquoted equity instruments' is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

BCA29 In paragraph BC101 'unquoted equity instrument' is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

BCA30 In the appendix of amendments to the Basis for Conclusions on other IFRSs, in paragraph BCA25 the amendment to paragraph BC29 of the Basis for Conclusions accompanying IFRIC 17 *Distributions of Non-cash Assets to Owners* is amended as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, amended paragraphs AG80 and AG81 of IAS 39 so that they apply only to derivatives on unquoted equity instruments. <u>IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value. IFRS 13 defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level</u>

<u>2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.</u>

IFRS 9 *Financial Instruments* (issued October 2010)

BCA31 In paragraph BC4.10 'the fair value hierarchy' is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value and for disclosing information about fair value measurements. IFRS 13 contains a three-level fair value hierarchy for the inputs used in valuation techniques to measure fair value and for the related disclosures. As a consequence paragraph 27A of IFRS 7 has been deleted.

BCA32 In paragraph BC4.11 'IFRS 7' is footnoted as follows:

* IFRS 13, issued in May 2011, requires disclosures about fair value measurements. As a consequence paragraph 27B(c) and (d) of IFRS 7 has been deleted.

BCA33 In paragraph BC4.53 'unquoted equity instruments' is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

BCA34 The heading above paragraph BCZ5.1 is footnoted as follows:

* IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 5.4.1–5.4.3 and B5.4.1–B5.4.13 of IFRS 9 have been deleted.

BCA35 In paragraph BCZ5.4 'most advantageous active market' is footnoted as follows:

* IFRS 13, issued in May 2011, states that a fair value measurement assumes that the transaction to sell an asset or to transfer a liability takes place in the principal market, or in the absence of a principal market, the most advantageous market for the asset or liability.

BCA36 In paragraph BCZ5.5 the first sentence is footnoted as follows:

* IFRS 13, issued in May 2011, states that fair value is measured using the price within the bid-ask spread that is most representative of fair value in the circumstances.

BCA37 Paragraph BCZ5.6 is footnoted as follows:

* IFRS 13, issued in May 2011, permits an exception to the fair value measurement requirements when an entity manages its financial assets and financial liabilities on the basis of the entity's net exposure to market risks or the credit risk of a particular counterparty, allowing the entity to measure the fair

value of its financial instruments on the basis of the entity's net exposure to either of those risks.

BCA38 In paragraph BCZ5.9 'fair value measurement hierarchy' is footnoted as follows:

* IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value.

BCA39 In paragraph BCZ5.10 'the best evidence of fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, describes when a transaction price might not represent the fair value of an asset or a liability at initial recognition.

BCA40 Paragraph BCZ5.10 is footnoted as follows:

* FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) superseded EITF Issue No. 02-3 *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Involved in Energy Trading and Risk Management Activities* (Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*® codified SFAS 157). As a result, IFRSs and US GAAP have different requirements for when an entity may recognise a gain or loss when there is a difference between fair value and the transaction price at initial recognition.

BCA41 The heading above paragraph BCZ5.11 is footnoted as follows:

* IFRS 13, issued in May 2011, resulted in the relocation of paragraphs BCZ5.11 and BCZ5.12 of IFRS 9 to paragraphs BCZ102 and BCZ103 of IFRS 13. As a consequence minor necessary edits have been made to that material.

BCA42 Paragraphs BCZ5.11 and BCZ5.12 are deleted.

BCA43 In the heading above BC5.13 'unquoted equity instruments' is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

BCA44 Paragraph BC5.17(a) is footnoted as follows:

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

BCA45 Paragraph BC5.17(b) is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

BCA46 In paragraph BC5.20 ‘unquoted equity instruments’ is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as ‘an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)’.

BCA47 Paragraph BC5.34A is added as follows:

BC5.34A IFRS 13, issued in May 2011, includes requirements for measuring the fair value of a liability issued with an inseparable third-party credit enhancement from the issuer’s perspective.

BCA48 In paragraph BC7.15 ‘unquoted equity instrument’ is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as ‘an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)’.

BCA49 In the appendix of amendments to the Basis for Conclusions on other IFRSs, in paragraph BCA7 the amended paragraph BC39D of the Basis for Conclusions accompanying IFRS 7 *Financial Instruments: Disclosures* is footnoted as follows:

* IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs B5.4.3–B5.4.5 of IFRS 9 have been deleted and paragraph B5.4.9 of IFRS 9 has been relocated to paragraphs B5.1.2A and B5.2.2A.

BCA50 In paragraph BCA20 the amended footnote to paragraph BCZ15(d) of the Basis for Conclusions accompanying IAS 36 is amended as follows:

* The IASB’s project to revise IAS 32 and IAS 39 in 2003 resulted in the relocation of the requirements on fair value measurement from IAS 32 to IAS 39. In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. <u>In 2011 the IASB’s project on fair value measurement resulted in the relocation of the requirements for measuring fair value to IFRS 13 *Fair Value Measurement*.</u>

BCA51 In paragraph BCA22 the amended footnote to paragraph BC12 of the Basis for Conclusions accompanying IAS 39 is amended as follows:

* In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. In October 2010 the Board amended IFRS 9 to add the requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities. Those requirements were relocated from IAS 39. <u>In 2011 the Board’s project on fair value measurement resulted in the relocation of the requirements for measuring fair value to IFRS 13.</u>

BCA52 In paragraph BCA32 the footnote to 'AG81' in paragraph BC29 of the Basis for Conclusions accompanying IFRIC 17 is amended as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, amended paragraphs AG80 and AG81 of IAS 39 so that they apply only to derivatives on unquoted equity instruments. IFRS 9, issued in October 2010, deleted paragraphs AG80 and AG81 of IAS 39. <u>IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value. IFRS 13 defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 and IFRS 9 refer to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.</u>

IAS 1 *Presentation of Financial Statements*

BCA53 Paragraph BC83 is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

IAS 19 *Employee Benefits*

BCA54 Paragraph BC3(i) is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA55 In paragraph BC69 'arm's length transaction' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value, describes the effect transaction costs have on a fair value measurement and addresses the application of bid and ask prices when measuring fair value.

IAS 27 *Consolidated and Separate Financial Statements*

BCA56 In paragraph BC22 the first sentence is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA57 In paragraph BC66 the first reference to 'fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA58 In paragraph BC66B 'fair value less costs to sell' is footnoted as follows:

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

IAS 28 *Investments in Associates*

BCA59 In paragraph BC7 the first sentence is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

IAS 31 *Interests in Joint Ventures*

BCA60 The heading above paragraph BC7 is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

IAS 36 *Impairment of Assets*

BCA61 At the end of the rubric above paragraph BC1 a paragraph is added as follows:

In developing IFRS 13 Fair Value Measurement*, issued in May 2011, the Board changed the definition of fair value less costs to sell. As a consequence all references to 'fair value less costs to sell' in IAS 36 were replaced with 'fair value less costs of disposal'. This Basis for Conclusions has not been amended to reflect that change.*

BCA62 Paragraph BCZ10(b) is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. As a result the term 'market value' has been changed to 'fair value'.

BCA63 In paragraph BCZ11(a) 'fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA64 In paragraph BCZ14 'fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value as an exit price.

BCA65 In paragraph BCZ15 the first reference to 'fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value. As a consequence the relevant requirements in IAS 16 and IAS 39 have been deleted from those Standards.

BCA66 In paragraph BCZ15(d) the footnote reference is amended as follows:

* The IASB's project to revise IAS 32 and IAS 39 in 2003 resulted in the relocation of the requirements on fair value measurement from IAS 32 to IAS 39. <u>In 2011 the IASB's project on fair value measurement resulted in the relocation of the requirements for measuring fair value to IFRS 13.</u>

BCA67 In paragraph BCZ16 the first sentence is footnoted as follows:

* IFRS 13, issued in May 2011, describes valuation techniques for measuring the fair value of an asset that is being used (and would not be sold) by an entity, eg a current replacement cost valuation technique.

BCA68 Paragraph BCZ19 is footnoted as follows:

* IFRS 13, issued in May 2011, describes the objective of a fair value measurement and the use of market participant assumptions.

BCA69 Paragraph BC58 is footnoted as follows:

* IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraph 27 of IAS 36 has been deleted.

BCA70 In paragraph BC68(b) 'fair value less costs to sell' is footnoted as follows:

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

BCA71 In paragraph BC69 'the Board observed that' is footnoted as follows:

* IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 25–27 of IAS 36 have been deleted.

BCA72 Paragraph BCZ99 is footnoted as follows:

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

BCA73 After paragraph BC209A a heading and paragraphs BC209B–BC209D are added as follows:

<u>Changes as a result of IFRS 13 *Fair Value Measurement*</u>

BC209B In developing IFRS 13, issued in May 2011, the Board was asked by users of financial statements to minimise the differences between the disclosures made about impaired assets in IFRSs and in US GAAP (which requires assets to be tested for impairment by comparing their carrying amount with their fair value). The Board noted that the disclosure requirements in IAS 36 were developed specifically to ensure consistency in the disclosure of information about impaired assets so that the same type of information is provided whether the recoverable amount was determined on the basis of value in use or fair value less costs of disposal. Consequently, the Board did not think it would be appropriate to require an entity to provide information when the recoverable amount is determined on the basis of fair value less costs of disposal (ie those required in IFRS 13) that is significantly different from what the entity would provide when the recoverable amount is determined on the basis of value in use.

BC209C Although IFRSs and US GAAP have different impairment models, the Board concluded that requiring the following information (in addition to what IAS 36 currently requires) about impaired assets measured at fair value less costs of disposal would improve comparability between entities applying IFRSs and those applying US GAAP as well as increase the convergence of IFRSs and US GAAP:

(a) the fair value less costs of disposal;

(b) the level of the fair value hierarchy within which the fair value less costs of disposal is categorised in its entirety (Level 1, 2 or 3);

(c) if applicable, changes to valuation techniques and reasons for those changes; and

(d) quantitative information about significant inputs used when measuring fair value less costs of disposal (along with a conforming amendment to the disclosures about value in use).

BC209D In addition, those disclosures are consistent with the disclosures required for non-recurring fair value measurements in IFRS 13 and in US GAAP.

IAS 38 *Intangible Assets*

BCA74 In paragraph BC17 the second sentence is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA75 In paragraph BC19A 'the asset's fair value' is footnoted as follows:

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

BCA76 In paragraph BC19D 'fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 40 and 41 of IAS 38 have been deleted.

BCA77 In paragraph BCZ38(c) the first reference to 'an active market' is footnoted as follows:

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

BCA78 In paragraph BCZ44(b) 'exists for the asset' is footnoted as follows:

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

BCA79 In paragraph BC50(b) 'an active market' is footnoted as follows:

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

BCA80 In paragraph BC57(b) 'an active market' is footnoted as follows:

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

BCA81 Paragraph BC69(b) is footnoted as follows:

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

BCA82 In paragraph BC73(b) 'an active market' is footnoted as follows:

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

BCA83 In paragraph BC83(b) 'an active market' is footnoted as follows:

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

IAS 39 *Financial Instruments: Recognition and Measurement* (as amended at October 2009)

BCA84 In paragraph BC89 the first reference to 'the fair value of a financial liability' is footnoted as follows:

> * IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA85 Paragraph BC91 is footnoted as follows:

> * IFRS 13, issued in May 2011, describes the objective of a fair value measurement of a liability.

BCA86 Paragraph BC92A is added as follows:

> BC92A IFRS 13, issued in May 2011, includes requirements for measuring the fair value of a liability issued with an inseparable third-party credit enhancement from the issuer's perspective.

BCA87 The heading above paragraph BC93 is footnoted as follows:

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

BCA88 Paragraphs BC93 and BC94 are deleted.

BCA89 The heading above paragraph BC95 is footnoted as follows:

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

BCA90 In paragraph BC95 the first sentence is footnoted as follows:

> * IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence in Appendix A of IAS 39 paragraphs AG69–AG75, AG76A–AG79 and AG82 have been deleted and paragraphs AG76, AG80 and AG81 have been amended.

BCA91 In paragraph BC97 'fair value as defined' is footnoted as follows:

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

BCA92 In paragraph BC98 'the most advantageous active market' is footnoted as follows:

* IFRS 13, issued in May 2011, states that a fair value measurement assumes that the transaction to sell an asset or to transfer a liability takes place in the principal market, or in the absence of a principal market, the most advantageous market for the asset or liability.

BCA93 In paragraph BC99 the first sentence is footnoted as follows:

* IFRS 13, issued in May 2011, states that fair value is measured using the price within the bid-ask spread that is most representative of fair value in the circumstances.

BCA94 Paragraph BC100 is footnoted as follows:

* IFRS 13, issued in May 2011, permits an exception to the fair value measurement requirements when an entity manages its financial assets and financial liabilities on the basis of the entity's net exposure to market risks or the credit risk of a particular counterparty, allowing the entity to measure the fair value of its financial instruments on the basis of the entity's net exposure to either of those risks.

BCA95 In paragraph BC103 'the fair value measurement hierarchy' is footnoted as follows:

* IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value.

BCA96 In paragraph BC104 'the best evidence of fair value' is footnoted as follows:

* IFRS 13, issued in May 2011, describes when a transaction price might not represent the fair value of an asset or a liability at initial recognition.

BCA97 Paragraph BC104 is footnoted as follows:

* FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) superseded EITF Issue No. 02-3 *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Involved in Energy Trading and Risk Management Activities* (Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*® codified SFAS 157). As a result, IFRSs and US GAAP have different requirements for when an entity may recognise a gain or loss when there is a difference between fair value and the transaction price at initial recognition.

BCA98 In paragraph BC105 'unquoted equity instruments' is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

IAS 40 *Investment Property*

BCA99 Paragraph B36 is footnoted as follows:

> * IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA100 The heading above paragraph B52 is footnoted as follows:

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

BCA101 Paragraph B53 is footnoted as follows:

> * The requirements for measuring fair value in IFRS 13, issued in May 2011, differ in some respects from the guidance for measuring market value in accordance with IVS 1. IFRS 13 deleted paragraphs 36, 37 and 42–44 of IAS 40.

BCA102 Paragraph B54 is footnoted as follows:

> * IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value. As a consequence paragraphs 38, 45–47, 49 and 51 of IAS 40 have been deleted.

BCA103 Paragraph B60 is footnoted as follows:

> * IFRS 13, issued in May 2011, discusses the measurement of fair value when the volume or level of activity for an asset has significantly decreased.

BCA104 In paragraph B67(a) 'the guidance on determining fair value was expanded, to clarify the following' and in paragraph B67(f) 'new disclosure requirements include' are footnoted as follows:

> * IFRS 13, issued in May 2011, contains the requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence paragraphs 37, 38, 45–47, 49, 51 and 75(d) of IAS 40 have been deleted.

IAS 41 *Agriculture*

BCA105 In paragraph BC5 the first reference to 'fair value' is footnoted as follows:

> * IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA106 Paragraph BC6 is footnoted as follows:

> * IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BCA107 Paragraph BC8 is footnoted as follows:

> * IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence, paragraph 21 of IAS 41 has been deleted.

BCA108 Paragraph B22 is footnoted as follows:

* IFRS 13, issued in May 2011, describes how transport costs are factored into a fair value measurement.

BCA109 The heading above paragraph B27 is footnoted as follows:

* IFRS 13, issued in May 2011, defines an active market and contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value.

BCA110 Paragraph B49 is footnoted as follows:

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

IFRIC 14 *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

BCA111 In paragraph BC16 ‘measured on a present value basis’ is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 does not specify a particular valuation technique for measuring the fair value of plan assets.

IFRIC 17 *Distributions of Non-cash Assets to Owners*

BCA112 In paragraph BC28(a) ‘a quoted market price in an active market’ is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 refers to unquoted equity instruments as ‘an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)’.

BCA113 In paragraph BC29 ‘a quoted price in an active market’ is footnoted as follows:

* IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 refers to unquoted equity instruments as ‘an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)’.

SIC-31 *Revenue—Barter Transactions Involving Advertising Services*

BCA114 In paragraph 8 the first sentence is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

SIC-32 *Intangible Assets—Web Site Costs*

BCA115 In paragraph 18 the first reference to 'an active market' is footnoted as follows:

* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 defines an active market.

HKFRS 13 IE
Issued June 2011

Illustrative Examples
Hong Kong Financial Reporting Standard 13

Fair Value Measurement

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

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IFRS 13 *Fair Value Measurement* Illustrative examples

These examples accompany, but are not part of, IFRS 13. They illustrate aspects of IFRS 13 but are not intended to provide interpretative guidance.

IE1 These examples portray hypothetical situations illustrating the judgements that might apply when an entity measures assets and liabilities at fair value in different valuation situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IFRS 13.

Highest and best use and valuation premise

IE2 Examples 1–3 illustrate the application of the highest and best use and valuation premise concepts for non-financial assets.

Example 1—Asset group

IE3 An entity acquires assets and assumes liabilities in a business combination. One of the groups of assets acquired comprises Assets A, B and C. Asset C is billing software integral to the business developed by the acquired entity for its own use in conjunction with Assets A and B (ie the related assets). The entity measures the fair value of each of the assets individually, consistently with the specified unit of account for the assets. The entity determines that the highest and best use of the assets is their current use and that each asset would provide maximum value to market participants principally through its use in combination with other assets or with other assets and liabilities (ie its complementary assets and the associated liabilities). There is no evidence to suggest that the current use of the assets is not their highest and best use.

IE4 In this situation, the entity would sell the assets in the market in which it initially acquired the assets (ie the entry and exit markets from the perspective of the entity are the same). Market participant buyers with whom the entity would enter into a transaction in that market have characteristics that are generally representative of both strategic buyers (such as competitors) and financial buyers (such as private equity or venture capital firms that do not have complementary investments) and include those buyers that initially bid for the assets. Although market participant buyers might be broadly classified as strategic or financial buyers, in many cases there will be differences among the market participant buyers within each of those groups, reflecting, for example, different uses for an asset and different operating strategies.

IE5 As discussed below, differences between the indicated fair values of the individual assets relate principally to the use of the assets by those market participants within different asset groups:

(a) Strategic buyer asset group. The entity determines that strategic buyers have related assets that would enhance the value of the group within which the assets would be used (ie market participant synergies). Those assets include a substitute asset for Asset C (the billing software), which would be used for only a limited transition period and could not be sold on its own at the end of that period. Because strategic buyers have substitute assets, Asset C would not be used for its full remaining economic life. The indicated fair values of Assets A, B and C within the strategic buyer asset group (reflecting the synergies resulting from the use of the assets within that group) are CU360,[*] CU260 and CU30, respectively. The indicated fair value of the assets as a group within the strategic buyer asset group is CU650.

(b) Financial buyer asset group. The entity determines that financial buyers do not have related or substitute assets that would enhance the value of the group within which the assets would be used. Because financial buyers do not have substitute assets, Asset C (ie the billing software) would be used for its full remaining economic life. The indicated fair values of Assets A, B and C within the financial buyer asset group are CU300, CU200 and CU100, respectively. The indicated fair value of the assets as a group within the financial buyer asset group is CU600.

IE6 The fair values of Assets A, B and C would be determined on the basis of the use of the assets as a group within the strategic buyer group (CU360, CU260 and CU30). Although the use of the assets within the strategic buyer group does not maximise the fair value of each of the assets individually, it maximises the fair value of the assets as a group (CU650).

Example 2—Land

IE7 An entity acquires land in a business combination. The land is currently developed for industrial use as a site for a factory. The current use of land is presumed to be its highest and best use unless market or other factors suggest a different use. Nearby sites have recently been developed for residential use as sites for high-rise apartment buildings. On the basis of that development and recent zoning and other changes to facilitate that development, the entity determines that the land currently used as a site for a factory could be developed as a site for residential use (ie for high-rise apartment buildings) because market participants would take into account the potential to develop the site for residential use when pricing the land.

IE8 The highest and best use of the land would be determined by comparing both of the following:

(a) the value of the land as currently developed for industrial use (ie the land would be used in combination with other assets, such as the factory, or with other assets and liabilities).

(b) the value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs (including the uncertainty about whether the entity would be able to convert the asset to the alternative use) necessary to convert the land to a vacant site (ie the land is to be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of those values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations, including its assets and liabilities.

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

Example 3—Research and development project

IE9 An entity acquires a research and development (R&D) project in a business combination. The entity does not intend to complete the project. If completed, the project would compete with one of its own projects (to provide the next generation of the entity's commercialised technology). Instead, the entity intends to hold (ie lock up) the project to prevent its competitors from obtaining access to the technology. In doing this the project is expected to provide defensive value, principally by improving the prospects for the entity's own competing technology. To measure the fair value of the project at initial recognition, the highest and best use of the project would be determined on the basis of its use by market participants. For example:

(a) The highest and best use of the R&D project would be to continue development if market participants would continue to develop the project and that use would maximise the value of the group of assets or of assets and liabilities in which the project would be used (ie the asset would be used in combination with other assets or with other assets and liabilities). That might be the case if market participants do not have similar technology, either in development or commercialised. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project, assuming that the R&D would be used with its complementary assets and the associated liabilities and that those assets and liabilities would be available to market participants.

(b) The highest and best use of the R&D project would be to cease development if, for competitive reasons, market participants would lock up the project and that use would maximise the value of the group of assets or of assets and liabilities in which the project would be used. That might be the case if market participants have technology in a more advanced stage of development that would compete with the project if completed and the project would be expected to improve the prospects for their own competing technology if locked up. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project, assuming that the R&D would be used (ie locked up) with its complementary assets and the associated liabilities and that those assets and liabilities would be available to market participants.

(c) The highest and best use of the R&D project would be to cease development if market participants would discontinue its development. That might be the case if the project is not expected to provide a market rate of return if completed and would not otherwise provide defensive value if locked up. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project on its own (which might be zero).

Use of multiple valuation techniques

IE10 The IFRS notes that a single valuation technique will be appropriate in some cases. In other cases multiple valuation techniques will be appropriate. Examples 4 and 5 illustrate the use of multiple valuation techniques.

Example 4—Machine held and used

IE11 An entity acquires a machine in a business combination. The machine will be held and used in its operations. The machine was originally purchased by the acquired entity from an outside vendor and, before the business combination, was customised by the acquired entity for use in its operations. However, the customisation of the machine was not extensive. The acquiring entity determines that the asset would provide maximum value to market participants through its use in combination with other assets or with other assets and liabilities (as installed or otherwise configured for use). There is no evidence to suggest that the current use of the machine is not its highest and best use. Therefore, the highest and best use of the machine is its current use in combination with other assets or with other assets and liabilities.

IE12 The entity determines that sufficient data are available to apply the cost approach and, because the customisation of the machine was not extensive, the market approach. The income approach is not used because the machine does not have a separately identifiable income stream from which to develop reliable estimates of future cash flows. Furthermore, information about short-term and intermediate-term lease rates for similar used machinery that otherwise could be used to project an income stream (ie lease payments over remaining service lives) is not available. The market and cost approaches are applied as follows:

(a) The market approach is applied using quoted prices for similar machines adjusted for differences between the machine (as customised) and the similar machines. The measurement reflects the price that would be received for the machine in its current condition (used) and location (installed and configured for use). The fair value indicated by that approach ranges from CU40,000 to CU48,000.

(b) The cost approach is applied by estimating the amount that would be required currently to construct a substitute (customised) machine of comparable utility. The estimate takes into account the condition of the machine and the environment in which it operates, including physical wear and tear (ie physical deterioration), improvements in technology (ie functional obsolescence), conditions external to the condition of the machine such as a decline in the market demand for similar machines (ie economic obsolescence) and installation costs. The fair value indicated by that approach ranges from CU40,000 to CU52,000.

IE13 The entity determines that the higher end of the range indicated by the market approach is most representative of fair value and, therefore, ascribes more weight to the results of the market approach. That determination is made on the basis of the relative subjectivity of the inputs, taking into account the degree of comparability between the machine and the similar machines. In particular:

(a) the inputs used in the market approach (quoted prices for similar machines) require fewer and less subjective adjustments than the inputs used in the cost approach.

(b) the range indicated by the market approach overlaps with, but is narrower than, the range indicated by the cost approach.

(c) there are no known unexplained differences (between the machine and the similar machines) within that range.

Accordingly, the entity determines that the fair value of the machine is CU48,000.

IE14 If customisation of the machine was extensive or if there were not sufficient data available to apply the market approach (eg because market data reflect transactions for machines used on a stand-alone basis, such as a scrap value for specialised assets, rather than machines used in combination with other assets or with other assets and liabilities), the entity would apply the cost approach. When an asset is used in combination with other assets or with other assets and liabilities, the cost approach assumes the sale of the machine to a market participant buyer with the complementary assets and the associated liabilities. The price received for the sale of the machine (ie an exit price) would not be more than either of the following:

(a) the cost that a market participant buyer would incur to acquire or construct a substitute machine of comparable utility; or

(b) the economic benefit that a market participant buyer would derive from the use of the machine.

Example 5—Software asset

IE15 An entity acquires a group of assets. The asset group includes an income-producing software asset internally developed for licensing to customers and its complementary assets (including a related database with which the software asset is used) and the associated liabilities. To allocate the cost of the group to the individual assets acquired, the entity measures the fair value of the software asset. The entity determines that the software asset would provide maximum value to market participants through its use in combination with other assets or with other assets and liabilities (ie its complementary assets and the associated liabilities). There is no evidence to suggest that the current use of the software asset is not its highest and best use. Therefore, the highest and best use of the software asset is its current use. (In this case the licensing of the software asset, in and of itself, does not indicate that the fair value of the asset would be maximised through its use by market participants on a stand-alone basis.)

IE16 The entity determines that, in addition to the income approach, sufficient data might be available to apply the cost approach but not the market approach. Information about market transactions for comparable software assets is not available. The income and cost approaches are applied as follows:

(a) The income approach is applied using a present value technique. The cash flows used in that technique reflect the income stream expected to result from the software asset (licence fees from customers) over its economic life. The fair value indicated by that approach is CU15 million.

(b) The cost approach is applied by estimating the amount that currently would be required to construct a substitute software asset of comparable utility (ie taking into account functional and economic obsolescence). The fair value indicated by that approach is CU10 million.

IE17 Through its application of the cost approach, the entity determines that market participants would not be able to construct a substitute software asset of comparable utility. Some characteristics of the software asset are unique, having been developed using proprietary information, and cannot be readily replicated. The entity determines that the fair value of the software asset is CU15 million, as indicated by the income approach.

Principal (or most advantageous) market

IE18 Example 6 illustrates the use of Level 1 inputs to measure the fair value of an asset that trades in different active markets at different prices.

Example 6—Level 1 principal (or most advantageous) market

IE19 An asset is sold in two different active markets at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date. In Market A, the price that would be received is CU26, transaction costs in that market are CU3 and the costs to transport the asset to that market are CU2 (ie the net amount that would be received is CU21). In Market B, the price that would be received is CU25, transaction costs in that market are CU1 and the costs to transport the asset to that market are CU2 (ie the net amount that would be received in Market B is CU22).

IE20 If Market A is the principal market for the asset (ie the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs (CU24).

IE21 If neither market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (ie the net amount that would be received in the respective markets).

IE22 Because the entity would maximise the net amount that would be received for the asset in Market B (CU22), the fair value of the asset would be measured using the price in that market (CU25), less transport costs (CU2), resulting in a fair value measurement of CU23. Although transaction costs are taken into account when determining which market is the most advantageous market, the price used to measure the fair value of the asset is not adjusted for those costs (although it is adjusted for transport costs).

Transaction prices and fair value at initial recognition

IE23 The IFRS clarifies that in many cases the transaction price, ie the price paid (received) for a particular asset (liability), will represent the fair value of that asset (liability) at initial recognition, but not presumptively. Example 7 illustrates when the price in a transaction involving a derivative instrument might (and might not) equal the fair value of the instrument at initial recognition.

Example 7—Interest rate swap at initial recognition

IE24 Entity A (a retail counterparty) enters into an interest rate swap in a retail market with Entity B (a dealer) for no initial consideration (ie the transaction price is zero). Entity A can access only the retail market. Entity B can access both the retail market (ie with retail counterparties) and the dealer market (ie with dealer counterparties).

IE25 From the perspective of Entity A, the retail market in which it initially entered into the swap is the principal market for the swap. If Entity A were to transfer its rights and obligations under the swap, it would do so with a dealer counterparty in that retail market. In that case the transaction price (zero) would represent the fair value of the swap to Entity A at initial recognition, ie the price that Entity A would receive to sell or pay to transfer the swap in a transaction with a dealer counterparty in the retail market (ie an exit price). That price would not be adjusted for any incremental (transaction) costs that would be charged by that dealer counterparty.

IE26 From the perspective of Entity B, the dealer market (not the retail market) is the principal market for the swap. If Entity B were to transfer its rights and obligations under the swap, it would do so with a dealer in that market. Because the market in which Entity B initially entered into the swap is different from the principal market for the swap, the transaction price (zero) would not necessarily represent the fair value of the swap to Entity B at initial recognition. If the fair value differs from the transaction price (zero), Entity B applies IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments* to determine whether it recognises that difference as a gain or loss at initial recognition.

Restricted assets

IE27 The effect on a fair value measurement arising from a restriction on the sale or use of an asset by an entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. Examples 8 and 9 illustrate the effect of restrictions when measuring the fair value of an asset.

Example 8—Restriction on the sale of an equity instrument

IE28 An entity holds an equity instrument (a financial asset) for which sale is legally or contractually restricted for a specified period. (For example, such a restriction could limit sale to qualifying investors.) The restriction is a characteristic of the instrument and, therefore, would be transferred to market participants. In that case the fair value of the instrument would be measured on the basis of the quoted price for an otherwise identical unrestricted equity instrument of the same issuer that trades in a public market, adjusted to reflect the effect of the restriction. The adjustment would reflect the amount market participants would demand because of the risk relating to the inability to access a public market for the instrument for the specified period. The adjustment will vary depending on all the following:

(a) the nature and duration of the restriction;

(b) the extent to which buyers are limited by the restriction (eg there might be a large number of qualifying investors); and

(c) qualitative and quantitative factors specific to both the instrument and the issuer.

Example 9—Restrictions on the use of an asset

IE29 A donor contributes land in an otherwise developed residential area to a not-for-profit neighbourhood association. The land is currently used as a playground. The donor specifies that the land must continue to be used by the association as a playground in perpetuity. Upon review of relevant documentation (eg legal and other), the association determines that the fiduciary responsibility to meet the donor's restriction would not be transferred to market participants if the association sold the asset, ie the donor restriction on the use of the land is specific to the association. Furthermore, the association is not restricted from selling the land. Without the restriction on the use of the land by the association, the land could be used as a site for residential development. In addition, the land is subject to an easement (ie a legal right that enables a utility to run power lines across the land). Following is an analysis of the effect on the fair value measurement of the land arising from the restriction and the easement:

(a) *Donor restriction on use of land*. Because in this situation the donor restriction on the use of the land is specific to the association, the restriction would not be transferred to market participants. Therefore, the fair value of the land would be the higher of its fair value used as a playground (ie the fair value of the asset would be maximised through its use by market participants in combination with other assets or with other assets and liabilities) and its fair value as a site for residential development (ie the fair value of the asset would be maximised through its use by market participants on a stand-alone basis), regardless of the restriction on the use of the land by the association.

(b) *Easement for utility lines*. Because the easement for utility lines is specific to (ie a characteristic of) the land, it would be transferred to market participants with the land. Therefore, the fair value measurement of the land would take into account the effect of the easement, regardless of whether the highest and best use is as a playground or as a site for residential development.

Measuring liabilities

IE30 A fair value measurement of a liability assumes that the liability, whether it is a financial liability or a non-financial liability, is transferred to a market participant at the measurement date (ie the liability would remain outstanding and the market participant transferee would be required to fulfil the obligation; it would not be settled with the counterparty or otherwise extinguished on the measurement date).

IE31 The fair value of a liability reflects the effect of non-performance risk. Non-performance risk relating to a liability includes, but may not be limited to, the entity's own credit risk. An entity takes into account the effect of its credit risk (credit standing) on the fair value of the liability in all periods in which the liability is measured at fair value because those that hold the entity's obligations as assets would take into account the effect of the entity's credit standing when estimating the prices they would be willing to pay.

IE32 For example, assume that Entity X and Entity Y each enter into a contractual obligation to pay cash (CU500) to Entity Z in five years. Entity X has a AA credit rating and can borrow at 6 per cent, and Entity Y has a BBB credit rating and can borrow at 12 per cent. Entity X will receive about CU374 in exchange for its promise (the present value of CU500 in five years at 6 per cent). Entity Y will receive about CU284 in exchange for its promise (the present value of CU500 in five years at 12 per cent). The fair value of the liability to each entity (ie the proceeds) incorporates that entity's credit standing.

IE33 Examples 10–13 illustrate the measurement of liabilities and the effect of non-performance risk (including an entity's own credit risk) on a fair value measurement.

Example 10—Structured note

IE34 On 1 January 20X7 Entity A, an investment bank with a AA credit rating, issues a five-year fixed rate note to Entity B. The contractual principal amount to be paid by Entity A at maturity is linked to an equity index. No credit enhancements are issued in conjunction with or otherwise related to the contract (ie no collateral is posted and there is no third-party guarantee). Entity A designated this note as at fair value through profit or loss. The fair value of the note (ie the obligation of Entity A) during 20X7 is measured using an expected present value technique. Changes in fair value are as follows:

(a) *Fair value at 1 January 20X7*. The expected cash flows used in the expected present value technique are discounted at the risk-free rate using the government bond curve at 1 January 20X7, plus the current market observable AA corporate bond spread to government bonds, if non-performance risk is not already reflected in the cash flows, adjusted (either up or down) for Entity A's specific credit risk (ie resulting in a credit-adjusted risk-free rate). Therefore, the fair value of Entity A's obligation at initial recognition takes into account non-performance risk, including that entity's credit risk, which presumably is reflected in the proceeds.

(b) *Fair value at 31 March 20X7*. During March 20X7 the credit spread for AA corporate bonds widens, with no changes to the specific credit risk of Entity A. The expected cash flows used in the expected present value technique are discounted at the risk-free rate using the government bond curve at 31 March 20X7, plus the current market observable AA corporate bond spread to government bonds, if non-performance risk is not already reflected in the cash flows, adjusted for Entity A's specific credit risk (ie resulting in a credit-adjusted risk-free rate). Entity A's specific credit risk is unchanged from initial recognition. Therefore, the fair value of Entity A's obligation changes as a result of changes in credit spreads generally. Changes in credit spreads reflect current market participant assumptions about changes in non-performance risk generally, changes in liquidity risk and the compensation required for assuming those risks.

(c) *Fair value at 30 June 20X7*. As of 30 June 20X7 there have been no changes to the AA corporate bond spreads. However, on the basis of structured note issues corroborated with other qualitative information, Entity A determines that its own specific creditworthiness has strengthened within the AA credit spread. The expected cash flows used in the expected present value technique are discounted at the risk-free rate using the government bond yield curve at 30 June 20X7, plus the current market observable AA corporate bond spread to government bonds (unchanged from 31 March 20X7), if non-performance risk is not already reflected in the cash flows, adjusted for Entity A's specific credit risk (ie resulting in a credit-adjusted risk-free rate). Therefore, the fair value of the obligation of Entity A changes as a result of the change in its own specific credit risk within the AA corporate bond spread.

Example 11—Decommissioning liability

IE35 On 1 January 20X1 Entity A assumes a decommissioning liability in a business combination. The entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years.

IE36 On the basis of paragraphs B23–B30 of the IFRS, Entity A uses the expected present value technique to measure the fair value of the decommissioning liability.

IE37 If Entity A was contractually allowed to transfer its decommissioning liability to a market participant, Entity A concludes that a market participant would use all the following inputs, probability-weighted as appropriate, when estimating the price it would expect to receive:

(a) labour costs;

(b) allocation of overhead costs;

(c) the compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset. Such compensation includes both of the following:

(i) profit on labour and overhead costs; and

(ii) the risk that the actual cash outflows might differ from those expected, excluding inflation;

(d) effect of inflation on estimated costs and profits;

(e) time value of money, represented by the risk-free rate; and

(f) non-performance risk relating to the risk that Entity A will not fulfil the obligation, including Entity A's own credit risk.

IE38 The significant assumptions used by Entity A to measure fair value are as follows:

(a) Labour costs are developed on the basis of current marketplace wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. Entity A assigns probability assessments to a range of cash flow estimates as follows:

Cash flow estimate (CU)	Probability assessment	Expected cash flows (CU)
100,000	25%	25,000
125,000	50%	62,500
175,000	25%	43,750
		CU131,250

The probability assessments are developed on the basis of Entity A's experience with fulfilling obligations of this type and its knowledge of the market.

(b) Entity A estimates allocated overhead and equipment operating costs using the rate it applies to labour costs (80 per cent of expected labour costs). This is consistent with the cost structure of market participants.

(c) Entity A estimates the compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset as follows:

(i) A third-party contractor typically adds a mark-up on labour and allocated internal costs to provide a profit margin on the job. The profit margin used (20 per cent) represents Entity A's understanding of the operating profit that contractors in the industry generally earn to dismantle and remove offshore oil platforms. Entity A concludes that this rate is consistent with the rate that a market participant would require as compensation for undertaking the activity.

(ii) A contractor would typically require compensation for the risk that the actual cash outflows might differ from those expected because of the uncertainty inherent in locking in today's price for a project that will not occur for 10 years. Entity A estimates the amount of that premium to be 5 per cent of the expected cash flows, including the effect of inflation.

(d) Entity A assumes a rate of inflation of 4 per cent over the 10-year period on the basis of available market data.

(e) The risk-free rate of interest for a 10-year maturity on 1 January 20X1 is 5 per cent. Entity A adjusts that rate by 3.5 per cent to reflect its risk of non-performance (ie the risk that it will not fulfil the obligation), including its credit risk. Therefore, the discount rate used to compute the present value of the cash flows is 8.5 per cent.

IE39 Entity A concludes that its assumptions would be used by market participants. In addition, Entity A does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability. As illustrated in the following table, Entity A measures the fair value of its decommissioning liability as CU194,879.

	Expected cash flows (CU) 1 January 20X1
Expected labour costs	131,250
Allocated overhead and equipment costs (0.80 × CU131,250)	105,000
Contractor's profit mark-up [0.20 × (CU131,250 + CU105,000)]	47,250
Expected cash flows before inflation adjustment	283,500
Inflation factor (4% for 10 years)	1.4802
Expected cash flows adjusted for inflation	419,637
Market risk premium (0.05 × CU419,637)	20,982
Expected cash flows adjusted for market risk	440,619
Expected present value using discount rate of 8.5% for 10 years	194,879

Example 12—Debt obligation: quoted price

IE40 On 1 January 20X1 Entity B issues at par a CU2 million BBB-rated exchange-traded five-year fixed rate debt instrument with an annual 10 per cent coupon. Entity B designated this financial liability as at fair value through profit or loss.

IE41 On 31 December 20X1 the instrument is trading as an asset in an active market at CU929 per CU1,000 of par value after payment of accrued interest. Entity B uses the quoted price of the asset in an active market as its initial input into the fair value measurement of its liability (CU929 × [CU2 million ÷ CU1,000] = CU1,858,000).

IE42 In determining whether the quoted price of the asset in an active market represents the fair value of the liability, Entity B evaluates whether the quoted price of the asset includes the effect of factors not applicable to the fair value measurement of a liability, for example, whether the quoted price of the asset includes the effect of a third-party credit enhancement if that credit enhancement would be separately accounted for from the perspective of the issuer. Entity B determines that no adjustments are required to the quoted price of the asset. Accordingly, Entity B concludes that the fair value of its debt instrument at 31 December 20X1 is CU1,858,000. Entity B categorises and discloses the fair value measurement of its debt instrument within Level 1 of the fair value hierarchy.

Example 13—Debt obligation: present value technique

IE43 On 1 January 20X1 Entity C issues at par in a private placement a CU2 million BBB-rated five-year fixed rate debt instrument with an annual 10 per cent coupon. Entity C designated this financial liability as at fair value through profit or loss.

IE44 At 31 December 20X1 Entity C still carries a BBB credit rating. Market conditions, including available interest rates, credit spreads for a BBB-quality credit rating and liquidity, remain unchanged from the date the debt instrument was issued. However, Entity C's credit spread has deteriorated by 50 basis points because of a change in its risk of non-performance. After taking into account all market conditions, Entity C concludes that if it was to issue the instrument at the measurement date, the instrument would bear a rate of interest of 10.5 per cent or Entity C would receive less than par in proceeds from the issue of the instrument.

IE45 For the purpose of this example, the fair value of Entity C's liability is calculated using a present value technique. Entity C concludes that a market participant would use all the following inputs (consistently with paragraphs B12–B30 of the IFRS) when estimating the price the market participant would expect to receive to assume Entity C's obligation:

(a) the terms of the debt instrument, including all the following:

   (i) coupon of 10 per cent;

   (ii) principal amount of CU2 million; and

   (iii) term of four years.

(b) the market rate of interest of 10.5 per cent (which includes a change of 50 basis points in the risk of non-performance from the date of issue).

IE46 On the basis of its present value technique, Entity C concludes that the fair value of its liability at 31 December 20X1 is CU1,968,641.

IE47 Entity C does not include any additional input into its present value technique for risk or profit that a market participant might require for compensation for assuming the liability. Because Entity C's obligation is a financial liability, Entity C concludes that the interest rate already captures the risk or profit that a market participant would require as compensation for assuming the liability. Furthermore, Entity C does not adjust its present value technique for the existence of a restriction preventing it from transferring the liability.

Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

IE48 Example 14 illustrates the use of judgement when measuring the fair value of a financial asset when there has been a significant decrease in the volume or level of activity for the asset when compared with normal market activity for the asset (or similar assets).

Example 14—Estimating a market rate of return when the volume or level of activity for an asset has significantly decreased

IE49 Entity A invests in a junior AAA-rated tranche of a residential mortgage-backed security on 1 January 20X8 (the issue date of the security). The junior tranche is the third most senior of a total of seven tranches. The underlying collateral for the residential mortgage-backed security is unguaranteed non-conforming residential mortgage loans that were issued in the second half of 20X6.

IE50 At 31 March 20X9 (the measurement date) the junior tranche is now A-rated. This tranche of the residential mortgage-backed security was previously traded through a brokered market. However, trading volume in that market was infrequent, with only a few transactions taking place per month from 1 January 20X8 to 30 June 20X8 and little, if any, trading activity during the nine months before 31 March 20X9.

IE51 Entity A takes into account the factors in paragraph B37 of the IFRS to determine whether there has been a significant decrease in the volume or level of activity for the junior tranche of the residential mortgage-backed security in which it has invested. After evaluating the significance and relevance of the factors, Entity A concludes that the volume and level of activity of the junior tranche of the residential mortgage-backed security have significantly decreased. Entity A supported its judgement primarily on the basis that there was little, if any, trading activity for an extended period before the measurement date.

IE52 Because there is little, if any, trading activity to support a valuation technique using a market approach, Entity A decides to use an income approach using the discount rate adjustment technique described in paragraphs B18–B22 of the IFRS to measure the fair value of the residential mortgage-backed security at the measurement date. Entity A uses the contractual cash flows from the residential mortgage-backed security (see also paragraphs 67 and 68 of the IFRS).

IE53 Entity A then estimates a discount rate (ie a market rate of return) to discount those contractual cash flows. The market rate of return is estimated using both of the following:

(a) the risk-free rate of interest.

(b) estimated adjustments for differences between the available market data and the junior tranche of the residential mortgage-backed security in which Entity A has invested. Those adjustments reflect available market data about expected non-performance and other risks (eg default risk, collateral value risk and liquidity risk) that market participants would take into account when pricing the asset in an orderly transaction at the measurement date under current market conditions.

IE54 Entity A took into account the following information when estimating the adjustments in paragraph IE53(b):

(a) the credit spread for the junior tranche of the residential mortgage-backed security at the issue date as implied by the original transaction price.

(b) the change in the credit spread implied by any observed transactions from the issue date to the measurement date for comparable residential mortgage-backed securities or on the basis of relevant indices.

(c) the characteristics of the junior tranche of the residential mortgage-backed security compared with comparable residential mortgage-backed securities or indices, including all the following:

(i) the quality of the underlying assets, ie information about the performance of the underlying mortgage loans such as delinquency and foreclosure rates, loss experience and prepayment rates;

(ii) the seniority or subordination of the residential mortgage-backed security tranche held; and

(iii) other relevant factors.

(d) relevant reports issued by analysts and rating agencies.

(e) quoted prices from third parties such as brokers or pricing services.

IE55 Entity A estimates that one indication of the market rate of return that market participants would use when pricing the junior tranche of the residential mortgage-backed security is 12 per cent (1,200 basis points). This market rate of return was estimated as follows:

(a) Begin with 300 basis points for the relevant risk-free rate of interest at 31 March 20X9.

(b) Add 250 basis points for the credit spread over the risk-free rate when the junior tranche was issued in January 20X8.

(c) Add 700 basis points for the estimated change in the credit spread over the risk-free rate of the junior tranche between 1 January 20X8 and 31 March 20X9. This estimate was developed on the basis of the change in the most comparable index available for that time period.

(d) Subtract 50 basis points (net) to adjust for differences between the index used to estimate the change in credit spreads and the junior tranche. The referenced index consists of subprime mortgage loans, whereas Entity A's residential mortgage-backed security consists of similar mortgage loans with a more favourable credit profile (making it more attractive to market participants). However, the index does not reflect an appropriate liquidity risk premium for the junior tranche under current market conditions. Thus, the 50 basis point adjustment is the net of two adjustments:

(i) the first adjustment is a 350 basis point subtraction, which was estimated by comparing the implied yield from the most recent transactions for the residential mortgage-backed security in June 20X8 with the implied yield in the index price on those same dates. There was no information available that indicated that the relationship between Entity A's security and the index has changed.

(ii) the second adjustment is a 300 basis point addition, which is Entity A's best estimate of the additional liquidity risk inherent in its security (a cash position) when compared with the index (a synthetic position). This estimate was derived after taking into account liquidity risk premiums implied in recent cash transactions for a range of similar securities.

IE56 As an additional indication of the market rate of return, Entity A takes into account two recent indicative quotes (ie non-binding quotes) provided by reputable brokers for the junior tranche of the residential mortgage-backed security that imply yields of 15–17 per cent. Entity A is unable to evaluate the valuation technique(s) or inputs used to develop the quotes. However, Entity A is able to confirm that the quotes do not reflect the results of transactions.

IE57 Because Entity A has multiple indications of the market rate of return that market participants would take into account when measuring fair value, it evaluates and weights the respective indications of the rate of return, considering the reasonableness of the range indicated by the results.

IE58 Entity A concludes that 13 per cent is the point within the range of indications that is most representative of fair value under current market conditions. Entity A places more weight on the 12 per cent indication (ie its own estimate of the market rate of return) for the following reasons:

(a) Entity A concluded that its own estimate appropriately incorporated the risks (eg default risk, collateral value risk and liquidity risk) that market participants would use when pricing the asset in an orderly transaction under current market conditions.

(b) The broker quotes were non-binding and did not reflect the results of transactions, and Entity A was unable to evaluate the valuation technique(s) or inputs used to develop the quotes.

Fair value disclosures

IE59 Examples 15–19 illustrate the disclosures required by paragraphs 92, 93(a), (b) and (d)–(h)(i) and 99 of the IFRS.

Example 15—Assets measured at fair value

IE60 For assets and liabilities measured at fair value at the end of the reporting period, the IFRS requires quantitative disclosures about the fair value measurements for each class of assets and liabilities. An entity might disclose the following for assets to comply with paragraph 93(a) and (b) of the IFRS:

(CU in millions)		Fair value measurements at the end of the reporting period using			
Description	31/12/X9	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total gains (losses)
Recurring fair value measurements					
Trading equity securities[(a)]:					
Real estate industry	93	70	23		
Oil and gas industry	45	45			
Other	15	15			
Total trading equity securities	153	130	23		
Other equity securities[(a)]:					
Financial services industry	150	150			
Healthcare industry	163	110		53	
Energy industry	32			32	
Private equity fund investments[(b)]	25			25	
Other	15	15			
Total other equity securities	385	275		110	
Debt securities:					
Residential mortgage-backed securities	149		24	125	
Commercial mortgage-backed securities	50			50	
Collateralised debt obligations	35			35	
Risk-free government securities	85	85			
Corporate bonds	93	9	84		
Total debt securities	412	94	108	210	
Hedge fund investments:					
Equity long/short	55		55		
Global opportunities	35		35		
High-yield debt securities	90			90	
Total hedge fund investments	180		90	90	

continued…

…continued

Description	31/12/X9	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total gains (losses)
Derivatives:					
Interest rate contracts	57		57		
Foreign exchange contracts	43		43		
Credit contracts	38			38	
Commodity futures contracts	78	78			
Commodity forward contracts	20		20		
Total derivatives	236	78	120	38	
Investment properties:					
Commercial—Asia	31			31	
Commercial—Europe	27			27	
Total investment properties	58			58	
Total recurring fair value measurements	1,424	577	341	506	
Non-recurring fair value measurements					
Assets held for sale[(c)]	26		26		(15)
Total non-recurring fair value measurements	26		26		(15)

(a) On the basis of its analysis of the nature, characteristics and risks of the securities, the entity has determined that presenting them by industry is appropriate.

(b) On the basis of its analysis of the nature, characteristics and risks of the investments, the entity has determined that presenting them as a single class is appropriate.

(c) In accordance with IFRS 5, assets held for sale with a carrying amount of CU35 million were written down to their fair value of CU26 million, less costs to sell of CU6 million (or CU20 million), resulting in a loss of CU15 million, which was included in profit or loss for the period.

(Note: A similar table would be presented for liabilities unless another format is deemed more appropriate by the entity.)

Example 16—Reconciliation of fair value measurements categorised within Level 3 of the fair value hierarchy

IE61 For recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the IFRS requires a reconciliation from the opening balances to the closing balances for each class of assets and liabilities. An entity might disclose the following for assets to comply with paragraph 93(e) and (f) of the IFRS:

(CU in millions)	Fair value measurements using significant unobservable inputs (Level 3)										
	Other equity securities			Debt securities			Hedge fund investments	Derivatives	Investment properties		
	Healthcare industry	Energy industry	Private equity fund	Residential mortgage-backed securities	Commercial mortgage-backed securities	Collateralised debt obligations	High-yield debt securities	Credit contracts	Asia	Europe	Total
Opening balance	49	28	20	105	39	25	145	30	28	26	495
Transfers into Level 3				60 [(a)(b)]							60
Transfers out of Level 3				(5) [(b)(c)]							(5)
Total gains or losses for the period											
Included in profit or loss			5	(23)	(5)	(7)	7	5	3	1	(14)
Included in other comprehensive income	3	1									4
Purchases, issues, sales and settlements											
Purchases	1	3			16	17		18			55
Issues											
Sales				(12)			(62)				(74)
Settlements								(15)			(15)
Closing balance	53	32	25	125	50	35	90	38	31	27	506
Change in unrealised gains or losses for the period included in profit or loss for assets held at the end of the reporting period			5	(3)	(5)	(7)	(5)	2	3	1	(9)

(a) Transferred from Level 2 to Level 3 because of a lack of observable market data, resulting from a decrease in market activity for the securities.

(b) The entity's policy is to recognise transfers into and transfers out of Level 3 as of the date of the event or change in circumstances that caused the transfer.

(c) Transferred from Level 3 to Level 2 because observable market data became available for the securities.

(Note: A similar table would be presented for liabilities unless another format is deemed more appropriate by the entity.)

IE62 Gains and losses included in profit or loss for the period (above) are presented in financial income and in non-financial income as follows:

(CU in millions)	Financial income	Non-financial income
Total gains or losses for the period included in profit or loss	(18)	4
Change in unrealised gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(13)	4

(Note: A similar table would be presented for liabilities unless another format is deemed more appropriate by the entity.)

Example 17—Valuation techniques and inputs

IE63 For fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, the IFRS requires an entity to disclose a description of the valuation technique(s) and the inputs used in the fair value measurement. For fair value measurements categorised within Level 3 of the fair value hierarchy, information about the significant unobservable inputs used must be quantitative. An entity might disclose the following for assets to comply with the requirement to disclose the significant unobservable inputs used in the fair value measurement in accordance with paragraph 93(d) of the IFRS:

Quantitative information about fair value measurements using significant unobservable inputs (Level 3)

(CU in millions)

Description	Fair value at 31/12/X9	Valuation technique(s)	Unobservable input	Range (weighted average)
Other equity securities:				
Healthcare industry	53	Discounted cash flow	weighted average cost of capital	7% – 16% (12.1%)
			long-term revenue growth rate	2% – 5% (4.2%)
			long-term pre-tax operating margin	3% – 20% (10.3%)
			discount for lack of marketability [(a)]	5% – 20% (17%)
			control premium[(a)]	10% – 30% (20%)
		Market comparable companies	EBITDA multiple [(b)]	10 – 13 (11.3)
			revenue multiple [(b)]	1.5 – 2.0 (1.7)
			discount for lack of marketability [(a)]	5% – 20% (17%)
			control premium [(a)]	10% – 30% (20%)
Energy industry	32	Discounted cash flow	weighted average cost of capital	8% – 12% (11.1%)
			long-term revenue growth rate	3% – 5.5% (4.2%)
			long-term pre-tax operating margin	7.5% – 13% (9.2%)
			discount for lack of marketability [(a)]	5% – 20% (10%)
			control premium [(a)]	10% – 20% (12%)
		Market comparable companies	EBITDA multiple [(b)]	6.5 – 12 (9.5)
			revenue multiple [(b)]	1.0 – 3.0 (2.0)
			discount for lack of marketability [(a)]	5% – 20% (10%)
			control premium [(a)]	10% – 20% (12%)
Private equity fund investments	25	Net asset value [(c)]	n/a	n/a
Debt securities:				
Residential mortgage-backed securities	125	Discounted cash flow	constant prepayment rate	3.5% – 5.5% (4.5%)
			probability of default	5% – 50% (10%)
			loss severity	40% – 100% (60%)
Commercial mortgage-backed securities	50	Discounted cash flow	constant prepayment rate	3% – 5% (4.1%)
			probability of default	2% – 25% (5%)
			loss severity	10% – 50% (20%)

continued…

continued…

Description	Fair value at 31/12/X9	Valuation technique(s)	Unobservable input	Range (weighted average)
Collateralised debt obligations	35	Consensus pricing	offered quotes	20 – 45
			comparability adjustments (%)	-10% – +15% (+5%)
Hedge fund Investments:				
High-yield debt securities	90	Net asset value [c]	n/a	n/a
Derivatives:				
Credit contracts	38	Option model	annualised volatility of credit [d]	10% – 20%
			Counterparty credit risk [e]	0.5% – 3.5%
			Own credit risk [e]	0.3% – 2.0%
Investment properties:				
Commercial – Asia	31	Discounted cash flow	long-term net operating income margin	18% – 32% (20%)
			cap rate	0.08 – 0.12 (0.10)
		Market comparable approach	price per square metre (USD)	\$3,000 – \$7,000 (\$4,500)
Commercial – Europe	27	Discounted cash flow	long-term net operating income margin	15% – 25% (18%)
			cap rate	0.06 – 0.10 (0.80)
		Market comparable approach	price per square metre (EUR)	€4,000 – €12,000 (€8,500)

(a) Represents amounts used when the entity has determined that market participants would take into account these premiums and discounts when pricing the investments.

(b) Represents amounts used when the entity has determined that market participants would use such multiples when pricing the investments.

(c) The entity has determined that the reported net asset value represents fair value at the end of the reporting period.

(d) Represents the range of the volatility curves used in the valuation analysis that the entity has determined market participants would use when the pricing contracts.

(e) Represents the range of the credit default swap spread curves used in the valuation analysis that the entity has determined market participants would use when pricing the contracts.

(Note: A similar table would be presented for liabilities unless another format is deemed more appropriate by the entity.)

IE64 In addition, an entity should provide additional information that will help users of its financial statements to evaluate the quantitative information disclosed. An entity might disclose some or all the following to comply with paragraph 92 of the IFRS:

(a) the nature of the item being measured at fair value, including the characteristics of the item being measured that are taken into account in the determination of relevant inputs. For example, for residential mortgage-backed securities, an entity might disclose the following:

(i) the types of underlying loans (eg prime loans or sub-prime loans)

(ii) collateral

(iii) guarantees or other credit enhancements

(iv) seniority level of the tranches of securities

(v) the year of issue

(vi) the weighted-average coupon rate of the underlying loans and the securities

(vii) the weighted-average maturity of the underlying loans and the securities

(viii) the geographical concentration of the underlying loans

(ix) information about the credit ratings of the securities.

(b) how third-party information such as broker quotes, pricing services, net asset values and relevant market data was taken into account when measuring fair value.

Example 18—Valuation processes

IE65 For fair value measurements categorised within Level 3 of the fair value hierarchy, the IFRS requires an entity to disclose a description of the valuation processes used by the entity. An entity might disclose the following to comply with paragraph 93(g) of the IFRS:

(a) for the group within the entity that decides the entity’s valuation policies and procedures:

(i) its description;

(ii) to whom that group reports; and

(iii) the internal reporting procedures in place (eg whether and, if so, how pricing, risk management or audit committees discuss and assess the fair value measurements);

(b) the frequency and methods for calibration, back testing and other testing procedures of pricing models;

(c) the process for analysing changes in fair value measurements from period to period;

(d) how the entity determined that third-party information, such as broker quotes or pricing services, used in the fair value measurement was developed in accordance with the IFRS; and

(e) the methods used to develop and substantiate the unobservable inputs used in a fair value measurement.

Example 19—Information about sensitivity to changes in significant unobservable inputs

IE66 For recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the IFRS requires an entity to provide a narrative description of the sensitivity of the fair value measurement to changes in significant unobservable inputs and a description of any interrelationships between those unobservable inputs. An entity might disclose the following about its residential mortgage-backed securities to comply with paragraph 93(h)(i) of the IFRS:

> The significant unobservable inputs used in the fair value measurement of the entity's residential mortgage-backed securities are prepayment rates, probability of default and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

Appendix
Amendments to guidance on other IFRSs

The following amendments to guidance on other IFRSs are necessary in order to ensure consistency with IFRS 13 Fair Value Measurement *and the related amendments to other IFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.*

IFRS 3 *Business Combinations*

IGA1 In the illustrative examples paragraph IE5 is amended as follows:

IE5 The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted ~~market~~ price of Entity A's shares in the principal (or most advantageous) market for the shares provides a more reliable basis for measuring the consideration effectively transferred than the ~~estimated~~ fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares—100 shares with a fair value per share of CU16.

IGA2 The example in paragraph IE72 is amended as follows:

Footnote X: Acquisitions

Paragraph reference

…

B64(f)(iv)	The fair value of the 100,000 ordinary shares issued as part of the consideration paid for TC (CU4,000) was ~~determined on the basis of~~ measured using the closing market price of AC's ordinary shares on the acquisition date.
B64(f)(iii)	...
B64(g) B67(b)	The fair value of the contingent consideration arrangement of CU1,000 was estimated by applying the income approach. The fair value ~~estimates are~~ measurement is based on significant inputs that are not observable in the market, which IFRS 13 *Fair Value Measurement* refers to as Level 3 inputs. Key assumptions include a ~~an assumed~~ discount rate range of 20–25 per cent and assumed probability-adjusted revenues in XC of CU10,000–20,000.

...

B64(o) The fair value of the non-controlling interest in TC, an unlisted company, was estimated by applying a market approach and an income approach. The fair value ~~estimates~~ measurements are based on significant inputs that are not observable in the market and thus represent a fair value measurement categorised within Level 3 of the fair value hierarchy as described in IFRS 13. Key assumptions include the following:

(a) ~~an assumed~~ a discount rate range of 20–25 per cent;

(b) ~~an assumed~~ a terminal value based on a range of terminal EBITDA multiples between 3 and 5 times (or, if appropriate, based on long-term sustainable growth rates ranging from 3 to 6 per cent);

(c) ~~assumed~~ financial multiples of companies deemed to be similar to TC; and

(d) ~~assumed~~ adjustments because of the lack of control or lack of marketability that market participants would consider when ~~estimating~~ measuring the fair value of the non-controlling interest in TC.

…

IGA3 In the comparison of IFRS 3 (as revised in January 2008) and SFAS 141(R), in the table below paragraph 3 the definition of fair value and the disclosures about a non-controlling interest in the acquiree are footnoted as follows:

Guidance	IFRS 3 (as revised in 2008)	SFAS 141(R)
Definition of fair value*	*Fair value* is defined as …	*Fair value* is defined in paragraph 5 of FASB Statement No. 157 *Fair Value Measurements* as …

* IFRS 13 *Fair Value Measurement* (issued in May 2011) defines fair value and contains the requirements for measuring fair value and for disclosing information about fair value measurements. As a result the definition of fair value in IFRSs is identical to the definition in US GAAP (Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*® codified FASB Statement No. 157).

Guidance	IFRS 3 (as revised in 2008)	SFAS 141(R)
Non-controlling interest in an acquiree**	**Disclosures** Because an acquirer is permitted to choose …	**Disclosures** SFAS 141(R) requires an acquirer to disclose …

** IFRS 13 (issued in May 2011) defines fair value and contains the requirements for measuring fair value and for disclosing information about fair value measurements. Although the disclosures required by IFRS 13 are not required for IFRS 3, the wording for the disclosures in IFRS 3 has been aligned with the wording in US GAAP (Topic 805 *Business Combinations* in the *FASB Accounting Standards Codification*® codified FASB Statement No. 141(R)).

IFRS 4 *Insurance Contracts*

IGA4 In the guidance on implementing IFRS 4 IG Example 3 is amended as follows:

IG Example 3: Unbundling a deposit component of a reinsurance contract
… If the reinsurer is required, or elects, to unbundle the contract, it does so as follows. Each payment by the cedant has two components: a loan advance (deposit component) and a payment for insurance cover (insurance component). Applying IAS 39 to the deposit component, the reinsurer is required to measure it initially at fair value. Fair value could be ~~determined~~ measured by discounting the future cash flows from the deposit component using a valuation technique. Assume that an appropriate discount rate is 10 per cent and that the insurance cover is equal in each year, so that the payment for insurance cover is the same in every year. Each payment of CU10 by the cedant is then made up of a loan advance of CU6.7 and an insurance premium of CU3.3. …

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

IGA5 In the guidance on implementing IFRS 5 Examples 10 and 13 are amended as follows:

Example 10

…

The entity ~~estimates that~~ measures the fair value less costs to sell of the disposal group ~~amounts to~~ as CU13,000. Because an entity measures a disposal group classified as held for sale at the lower of its carrying amount and fair value less costs to sell, the entity recognises an impairment loss of CU1,900 (CU14,900 – CU13,000) when the group is initially classified as held for sale.

…

Example 13

…

The ~~estimated~~ fair value less costs to sell of S2 is CU135. A accounts for S2 as follows:

…

IFRS 7 *Financial Instruments: Disclosures* (as amended at October 2009)

IGA6 In the guidance on implementing IFRS 7 paragraphs IG13A and IG13B, and their accompanying tables, are deleted.

IGA7 Paragraph IG14 is amended as follows:

IG14 The fair value at initial recognition of financial instruments that are not traded in active markets is ~~determined~~ measured in accordance with IFRS 13 *Fair Value Measurement* and paragraph AG76 of IAS 39. ... Such recognition reflects changes in factors (including time) that market participants would ~~consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~AG76A~~ AG76(b) of IAS 39). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

Background

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to ~~establish~~ measure the financial assets' fair value. This valuation technique ~~includes variables~~ uses inputs other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at 1 January 20X1.

Application of requirements

The entity's 20X2 disclosure would include the following:

Accounting policies

The entity uses the following valuation technique to ~~determine~~ measure the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IFRS 13 and IAS 39, is ~~generally~~ normally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IAS 39, the fair value of an instrument at inception is ~~generally~~ normally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy]. The differences yet to be recognised in profit or loss are as follows:

…

IFRS 9 *Financial Instruments* (issued November 2009)

IGA8 In the amendments to guidance on other IFRSs, in paragraph IGA6 the amendment to the illustrative disclosure in paragraph IG14 of the Implementation Guidance accompanying IFRS 7 is amended as follows:

IG14 The fair value at initial recognition of financial instruments that are not traded in active markets is ~~determined~~ measured in accordance with IFRS 13 *Fair Value Measurement* and paragraph AG76 of IAS 39 (for financial liabilities) or paragraph B5.1 of IFRS 9 (for financial assets). ... Such recognition reflects changes in factors (including time) that market participants would ~~consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~AG76A~~ AG76(b) of IAS 39). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

Background

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to ~~establish~~ measure the financial assets' fair value. This valuation technique ~~includes variables~~ uses inputs other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at 1 January 20X1.

Application of requirements

The entity's 20X2 disclosure would include the following:

Accounting policies

The entity uses the following valuation technique to ~~determine~~ measure the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IFRS 13 and IFRS 9, is ~~generally~~ normally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IFRS 9, the fair value of an instrument at inception is ~~generally~~ normally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy]. The differences yet to be recognised in profit or loss are as follows:

…

IFRS 9 *Financial Instruments* (issued October 2010)

IGA9 In the amendments to the guidance on other IFRSs, in paragraph IGA14 the amendment to paragraph IG14 in the implementation guidance accompanying IFRS 7 the illustrative disclosure is amended as follows:

IG14 ~~The fair value at~~ At initial recognition an entity measures the fair value of financial instruments that are not traded in active markets ~~is determined in accordance with paragraph B5.4.8 of IFRS 9~~. ... Such recognition reflects changes in factors (including time) that market participants would ~~consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~B5.4.9~~ B5.1.2(b) of IFRS 9). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

Background

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to ~~establish~~ measure the financial assets' fair value. This valuation technique ~~includes variables~~ uses inputs other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at 1 January 20X1.

Application of requirements

The entity's 20X2 disclosure would include the following:

Accounting policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IFRS 13 and IFRS 9, is ~~generally~~ normally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IFRS 9, the fair value of an instrument at inception is ~~generally~~ normally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy]. The differences yet to be recognised in profit or loss are as follows:

…

IAS 34 *Interim Financial Reporting*

IGA10 Paragraphs C4 and C7 are amended as follows:

C4 **Pensions:** IAS 19 *Employee Benefits* requires ~~that~~ an entity to determine the present value of defined benefit obligations and the ~~market~~ fair value of plan assets at the end of each reporting period and encourages an entity to involve a professionally qualified actuary in measurement of the obligations. For interim reporting purposes, reliable measurement is often obtainable by extrapolation of the latest actuarial valuation.

C7 **Revaluations and fair value accounting:** IAS 16 *Property, Plant and Equipment* allows an entity to choose as its accounting policy the revaluation model whereby items of property, plant and equipment are revalued to fair value. Similarly, IAS 40 *Investment Property* requires an entity to ~~determine~~ measure the fair value of investment property. For those measurements, an entity may rely on professionally qualified valuers at annual reporting dates though not at interim reporting dates.

IAS 36 *Impairment of Assets*

IGA11 In the illustrative examples all references to 'fair value less costs to sell' are replaced with 'fair value less costs of disposal'.

IAS 39 *Financial Instruments: Recognition and Measurement*

IGA12 In the guidance on implementing IAS 39 Questions and answers E.2.1 and E.2.2 are deleted.

IAS 41 *Agriculture*

IGA13 In the illustrative examples Example 1 is amended as follows:

...

Notes

1 Operations and principal activities

XYZ Dairy Ltd ('the Company') is engaged in milk production for supply to various customers. At 31 December 20X1, the Company held 419 cows able to produce milk (mature assets) and 137 heifers being raised to produce milk in the future (immature assets). The Company produced 157,584kg of milk with a fair value less costs to sell of 518,240 (~~that is determined~~ at the time of milking) in the year ended 31 December 20X1.

2 Accounting policies

Livestock and milk

Livestock are measured at their fair value less costs to sell. The fair value of livestock is ~~determined~~ based on quoted ~~market~~ prices of livestock of similar age, breed, and genetic merit in the principal (or most advantageous) market for the livestock. Milk is initially measured at its fair value less costs to sell at the time of milking. The fair value of milk is ~~determined~~ based on quoted ~~market~~ prices in the local area in the principal (or most advantageous) market for the milk.

…

IFRIC 12 *Service Concession Arrangements*

IGA14 Paragraphs IE15 and IE31 are amended as follows:

IE15 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as an intangible asset (licence to charge users of the infrastructure). The operator ~~estimates~~ measures the fair value of its consideration received ~~to be~~ as equal to the forecast construction costs plus 5 per cent margin, which the operator concludes is consistent with the rate that a market participant would require as compensation for providing the construction services and for assuming the risk associated with the construction costs. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase of the arrangement:

...

IE31 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as a right to receive a licence to charge users of the infrastructure. The operator ~~estimates~~ measures the fair value of its consideration received or receivable as equal to the forecast construction costs plus 5 per cent, which the operator concludes is consistent with the rate that a market participant would require as compensation for providing the construction services and for assuming the risk associated with the construction costs. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase:

...

IFRIC 13 *Customer Loyalty Programmes*

IGA15 Paragraphs IE1 and IE3 are amended as follows:

IE1 A grocery retailer operates a customer loyalty programme. It grants programme members loyalty points when they spend a specified amount on groceries. Programme members can redeem the points for further groceries. The points have no expiry date. In one period, the entity grants 100 points. Management ~~estimates~~ measures the fair value of groceries for which each loyalty point can be redeemed as 1.25 currency units (CU1.25). This amount takes into account ~~an~~ management's estimate of the discount that ~~management~~ market participants would assume when pricing the award credits. That discount takes into account market participants' expectations of the discount that ~~expects~~ would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management estimates that market participants would expect~~s~~ only 80 of these points to be redeemed. Therefore, the fair value of each point is CU1, being the fair value of the award for each loyalty point granted of CU1.25 reduced to take into account points not expected to be redeemed ((80 points/100 points) × CU1.25 = CU1). Accordingly, management defers recognition of revenue of CU100. Throughout the example, management determines that non-performance risk has an immaterial effect on the measurement of its obligation under the programme.

IE3 In the second year, management revises its estimate of market participants' expectations. It now expects 90 points to be redeemed altogether.

IFRIC 14 *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

IGA16 In the illustrative examples all references to 'market value' of assets are replaced with 'fair value'.

HK(SIC)-Int 12
~~Issued March 2004~~Revised June 2011

Effective for annual periods beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 12

Consolidation — Special Purpose Entities

This HK(SIC) Interpretation is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2013. HKFRS 10 *Consolidated Financial Statements* issued in June 2011 is applicable for annual periods beginning on or after 1 January 2013 and supersedes this HK(SIC) Interpretation.

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HK(SIC)-Int 13
Revised ~~August 2010~~June 2011

Effective for annual periods beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 13

Jointly Controlled Entities — Non-Monetary Contributions by Venturers

This HK(SIC) Interpretation is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2013. HKFRS 11 *Joint Arrangements* issued in June 2011 is applicable for annual periods beginning on or after 1 January 2013 and supersedes this HK(SIC) Interpretation.

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