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

MEMBERS' HANDBOOK

Update No. 91

(Issued 30 August 2010)

Handbook Improvements only

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Insert the revised pages i, iii and iv. Discard the replaced pages i, iii and iv.	Revised contents pages

Amendments to the following Interpretations, Basis for Conclusions and Illustrative Examples were previously set out in the Appendix to the Interpretations as they were not yet effective. The Institute has taken this opportunity to incorporate the amendments applicable on 1 January 2010 in the relevant affected Interpretations, Basis for Conclusions and Illustrative Examples, for greater clarity.

Reference to HKAS/HKFRS contained in respective Implementation Guidance and Illustrative Examples are amended to IAS/IFRS to comply with relevant requirements contained in the International Accounting Standards Board license agreement.

This update 91 covers 9 documents set out below.

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

HK(IFRIC)-Int 12 *Service Concession Arrangements*	Replace the Interpretation with revised Interpretation	Amendments due to - HKAS 1 (Revised) - HKAS 23 (Revised) - HKFRS 9 - Editorial corrections to comply with IASB license agreement
HK(IFRIC)-Int 15 *Agreements for the Construction of Real Estate*	Replace the Interpretation with revised Interpretation	Amendments due to - Editorial corrections to comply with IASB license agreement

HK(IFRIC)-Int 16 *Hedges of a Net Investment in a Foreign Operation*	Replace the Interpretation with revised Interpretation	Amendments due to - *Improvements to HKFRSs 2009* - Editorial corrections to comply with IASB license agreement
HK(IFRIC)-Int 17 *Distributions of Non-cash Assets to Owners*	Replace the Interpretation with revised Interpretation	Amendments due to - HKFRS 9 - Editorial corrections to comply with IASB license agreement
HK(IFRIC)-Int 18 *Transfers of Assets from Customers*	Replace pages 8 and 9 with revised pages 8 and 9	Amendments due to - Editorial corrections to comply with IASB license agreement

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

HK(SIC)-Int 10 *Government Assistance – No Specific Relation to Operating Activities*	Replace the Interpretation with revised Interpretation	Amendments due to - HKAS 1 (Revised)
HK(SIC)-Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*	Replace the Interpretation with revised Interpretation	Amendments due to - HKAS 1 (Revised)
HK(SIC)-Int 25 *Income Taxes – Changes in the Tax Status of an Entity or its Shareholders*	Replace the Interpretation with revised Interpretation	Amendments due to - HKAS 1 (Revised)
HK(SIC)-Int 29 *Service Concession Arrangements: Disclosures*	Replace the Interpretation with revised Interpretation	Amendments due to - HKAS 1 (Revised)

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MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to August 2010)

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

HK(IFRIC)-Int 12
~~Issued March 2007~~Revised August 2010

Effective for annual periods
beginning on or after 1 January 2008

HK(IFRIC) Interpretation 12

Service Concession Arrangements

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

CONTENTS

Hong Kong (IFRIC) Interpretation 12 *Service Concession Arrangements* (HK(IFRIC)-Int 12) is set out in paragraphs 1-30 and Appendices A, B and C. HK(IFRIC)-Int 12 is accompanied by information notes, illustrative examples and a basis for conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 12
Service Concession Arrangements

References

- *Framework for the Preparation and Presentation of Financial Statements*
- HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*
- HKFRS 7 *Financial Instruments: Disclosures*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 11 *Construction Contracts*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 17 *Leases*
- HKAS 18 *Revenue*
- HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- HKAS 23 *Borrowing Costs*
- HKAS 32 *Financial Instruments: Presentation*
- HKAS 36 *Impairment of Assets*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- HKAS 38 *Intangible Assets*
- HKAS 39 *Financial Instruments: Recognition and Measurement*
- HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*
- HK(SIC)-Int 29 *Service Concession Arrangements: Disclosures**

Background

1 In many countries, infrastructure for public services–such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks–has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

2 In some countries, governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of such infrastructure. The infrastructure may already exist, or may be constructed during the period of the service arrangement. An arrangement within the scope of this Interpretation typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

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* The title of HK(SIC)-Int 29, formerly *Disclosure – Service Concession Arrangements*, was amended by HK(IFRIC)-Int 12.

3 A feature of these service arrangements is the public service nature of the obligation undertaken by the operator. Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:

(a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.

(b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.

(c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.

(d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

Scope

4 This Interpretation gives guidance on the accounting by operators for public-to-private service concession arrangements.

5 This Interpretation applies to public-to-private service concession arrangements if:

(a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and

(b) the grantor controls–through ownership, beneficial entitlement or otherwise–any significant residual interest in the infrastructure at the end of the term of the arrangement.

6 Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole of life assets) is within the scope of this Interpretation if the conditions in paragraph 5(a) are met. Paragraphs AG1–AG8 provide guidance on determining whether, and to what extent, public-to-private service concession arrangements are within the scope of this Interpretation.

7 This Interpretation applies to both:

(a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and

(b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.

8 This Interpretation does not specify the accounting for infrastructure that was held and recognised as property, plant and equipment by the operator before entering the service arrangement. The derecognition requirements of HKFRSs (set out in HKAS 16) apply to such infrastructure.

9 This Interpretation does not specify the accounting by grantors.

Issues

10 This Interpretation sets out general principles on recognising and measuring the obligations and related rights in service concession arrangements. Requirements for disclosing information about service concession arrangements are in HK(SIC)-Int 29. The issues addressed in this Interpretation are:

(a) treatment of the operator's rights over the infrastructure;

(b) recognition and measurement of arrangement consideration;

(c) construction or upgrade services;

(d) operation services;

(e) borrowing costs;

(f) subsequent accounting treatment of a financial asset and an intangible asset; and

(g) items provided to the operator by the grantor.

Conclusions

Treatment of the operator's rights over the infrastructure

11 Infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

Recognition and measurement of arrangement consideration

12 Under the terms of contractual arrangements within the scope of this Interpretation, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

13 The operator shall recognise and measure revenue in accordance with HKASs 11 and 18 for the services it performs. If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable. The nature of the consideration determines its subsequent accounting treatment. The subsequent accounting for consideration received as a financial asset and as an intangible asset is detailed in paragraphs 23-26 below.

Construction or upgrade services

14 The operator shall account for revenue and costs relating to construction or upgrade services in accordance with HKAS 11.

Consideration given by the grantor to the operator

15 If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised at its fair value. The consideration may be rights to:

(a) a financial asset, or

(b) an intangible asset.

16 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

17 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

18 If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognised initially at the fair value of the consideration received or receivable.

19 The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant contract law.

Operation services

20 The operator shall account for revenue and costs relating to operation services in accordance with HKAS 18.

Contractual obligations to restore the infrastructure to a specified level of serviceability

21 The operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructure, except for any upgrade element (see paragraph 14), shall be recognised and measured in accordance with HKAS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the ~~balance sheet date~~end of the reporting period.

Borrowing costs incurred by the operator

22 In accordance with HKAS 23, borrowing costs attributable to the arrangement shall be recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case borrowing costs attributable to the arrangement ~~may~~ shall be capitalised during the construction phase of the arrangement in accordance with ~~the allowed alternative treatment under~~ that Standard.

Financial asset

23 HKASs 32 and 39 and HKFRS 7 apply to the financial asset recognised under paragraphs 16 and 18.

24 The amount due from or at the direction of the grantor is accounted for in accordance with HKAS 39 as:

(a) a loan or receivable;

(b) an available-for-sale financial asset; or

(c) if so designated upon initial recognition, a financial asset at fair value through profit or loss, if the conditions for that classification are met.

25 If the amount due from the grantor is accounted for either as a loan or receivable or as an available-for-sale financial asset, HKAS 39 requires interest calculated using the effective interest method to be recognised in profit or loss.

Intangible asset

26 HKAS 38 applies to the intangible asset recognised in accordance with paragraphs 17 and 18. Paragraphs 45-47 of HKAS 38 provide guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets.

Items provided to the operator by the grantor

27 In accordance with paragraph 11, infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognised as property, plant and equipment of the operator. The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in HKAS 20. They are recognised as assets of the operator, measured at fair value on initial recognition. The operator shall recognise a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.

Effective date

28 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 January 2008, it shall disclose that fact.

Transition

29 Subject to paragraph 30, changes in accounting policies are accounted for in accordance with HKAS 8, ie retrospectively.

30 If, for any particular service arrangement, it is impracticable for an operator to apply this Interpretation retrospectively at the start of the earliest period presented, it shall:

(a) recognise financial assets and intangible assets that existed at the start of the earliest period presented;

(b) use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and

(c) test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts shall be tested for impairment as at the start of the current period.

Appendix A
Application guidance

This appendix is an integral part of the Interpretation.

Scope (paragraph 5)

AG1 Paragraph 5 of this Interpretation specifies that infrastructure is within the scope of the Interpretation when the following conditions apply:

(a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and

(b) the grantor controls–through ownership, beneficial entitlement or otherwise–any significant residual interest in the infrastructure at the end of the term of the arrangement.

AG2 The control or regulation referred to in condition (a) could be by contract or otherwise (such as through a regulator), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. In applying this condition, the grantor and any related parties shall be considered together. If the grantor is a public sector entity, the public sector as a whole, together with any regulators acting in the public interest, shall be regarded as related to the grantor for the purposes of this Interpretation.

AG3 For the purpose of condition (a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, contract or regulator, for example by a capping mechanism. However, the condition shall be applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored. Conversely, if for example, a contract purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.

AG4 For the purpose of condition (b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the infrastructure and give the grantor a continuing right of use throughout the period of the arrangement. The residual interest in the infrastructure is the estimated current value of the infrastructure as if it were already of the age and in the condition expected at the end of the period of the arrangement.

AG5 Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 5(a) and any significant residual interest in the infrastructure, the operator is only managing the infrastructure on the grantor's behalf–even though, in many cases, it may have wide managerial discretion.

AG6 Conditions (a) and (b) together identify when the infrastructure, including any replacements required (see paragraph 21), is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an item of infrastructure during the period of the arrangement (eg the top layer of a road or the roof of a building), the item of infrastructure shall be considered as a whole. Thus condition (b) is met for the whole of the infrastructure, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.

AG7 Sometimes the use of infrastructure is partly regulated in the manner described in paragraph 5(a) and partly unregulated. However, these arrangements take a variety of forms:

(a) any infrastructure that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in HKAS 36 shall be analysed separately if it is used wholly for unregulated purposes. For example, this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients.

(b) when purely ancillary activities (such as a hospital shop) are unregulated, the control tests shall be applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 5, the existence of ancillary activities does not detract from the grantor's control of the infrastructure.

AG8 The operator may have a right to use the separable infrastructure described in paragraph AG7(a), or the facilities used to provide ancillary unregulated services described in paragraph AG7(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it shall be accounted for in accordance with HKAS 17.

Appendix B
Amendments to HKFRS 1 and to other Interpretations

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2008. If an entity applies this Interpretation for an earlier period, these amendments shall be applied for that earlier period.

* * *

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

Appendix C

Amendments resulting from other HKFRSs

The following sets out amendments required for this Interpretation resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Interpretation and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013

In the 'References' section, a reference to HKFRS 9 *Financial Instruments* is added. Paragraphs 23–25 are amended and paragraph 28A is added as follows:

23 HKASs 32 and 39 and HKFRSs 7 and 9 apply to the financial asset recognised under paragraphs 16 and 18.

24 The amount due from or at the direction of the grantor is accounted for in accordance with HKFRS 9 ~~HKAS 39~~ as:

(a) at amortised cost ~~a loan or receivable~~; or

(b) measured at fair value through profit or loss ~~an available-for-sale financial asset; or~~.

~~(c) if so designated upon initial recognition, a financial asset at fair value through profit or loss, if the conditions for that classification are met.~~

25 If the amount due from the grantor is accounted for ~~either as a loan or receivable or as an available-for-sale financial asset~~ at amortised cost, HKFRS 9 ~~HKAS 39~~ requires interest calculated using the effective interest method to be recognised in profit or loss.

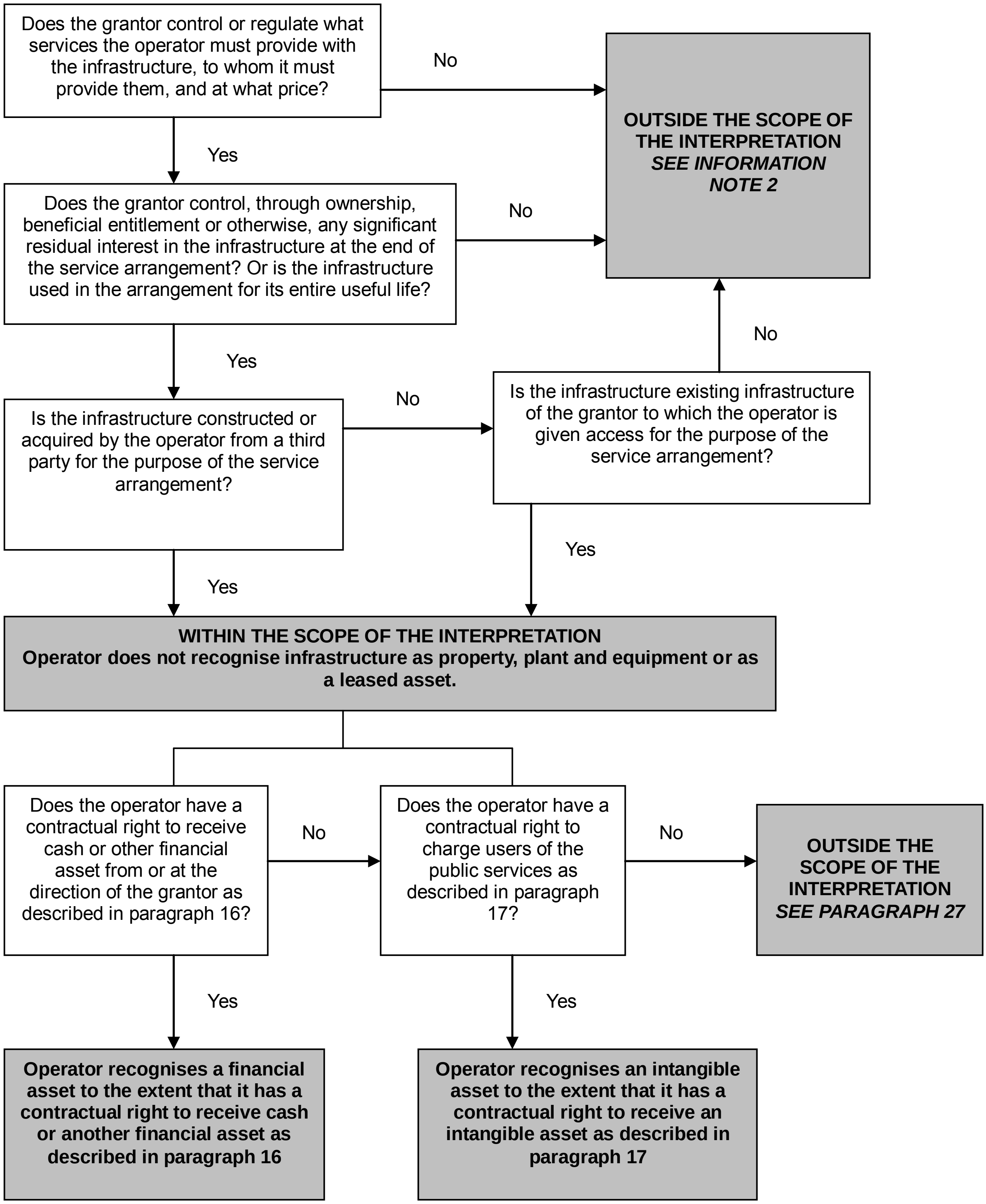
28A HKFRS 9, issued in November 2009, amended paragraphs 23–25. An entity shall apply those amendments when it applies HKFRS 9.

Information note 1

Accounting framework for public-to-private service arrangements

This note accompanies, but is not part of, IFRIC 12.

The diagram below summarises the accounting for service arrangements established by IFRIC 12.



Information note 2

References to IFRSs that apply to typical types of public-to-private arrangements

This note accompanies, but is not part of, IFRIC 12.

The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to IFRSs that apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not the IFRIC's intention to convey the impression that bright lines exist between the accounting requirements for public-to-private arrangements.

<table>
<tr><th>Category</th><th>Lessee</th><th colspan="3">Service provider</th><th colspan="2">Owner</th></tr>
<tr><td>Typical arrangement types</td><td>Lease (eg Operator leases asset from grantor)</td><td>Service and/or maintenance contract (specific tasks eg debt collection)</td><td>Rehabilitate-operate-transfer</td><td>Build-operate-transfer</td><td>Build-own-operate</td><td>100% Divestment/ Privatisation/ Corporation</td></tr>
<tr><td>Asset ownership</td><td colspan="4">Grantor</td><td colspan="2">Operator</td></tr>
<tr><td>Capital investment</td><td colspan="2">Grantor</td><td colspan="4">Operator</td></tr>
<tr><td>Demand risk</td><td>Shared</td><td>Grantor</td><td colspan="2">Operator and/or Grantor</td><td colspan="2">Operator</td></tr>
<tr><td>Typical duration</td><td>8 – 20 years</td><td>1 – 5 years</td><td colspan="3">25-30 years</td><td>Indefinite (or may be limited by licence)</td></tr>
<tr><td>Residual interest</td><td colspan="4">Grantor</td><td colspan="2">Operator</td></tr>
<tr><td>Relevant IFRSs</td><td>IAS 17</td><td>IAS 18</td><td colspan="2">IFRIC 12</td><td colspan="2">IAS 16</td></tr>
</table>

Illustrative examples

These examples accompany, but are not part of, IFRIC 12.

Example 1: The grantor gives the operator a financial asset

Arrangement terms

IE1 The terms of the arrangement require an operator to construct a road–completing construction within two years–and maintain and operate the road to a specified standard for eight years (ie years 3-10). The terms of the arrangement also require the operator to resurface the road at the end of year 8–the resurfacing activity is revenue-generating. At the end of year 10, the arrangement will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Table 1.1 ***Contract costs***

	Year	CU*
Construction services	1	500
	2	500
Operation services (per year)	3-10	10
Road resurfacing	8	100

* in this example, monetary amounts are denominated in 'currency units (CU) '.

IE2 The terms of the arrangement require the grantor to pay the operator 200 currency units (CU200) per year in years 3-10 for making the road available to the public.

IE3 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Contract revenue

IE4 The operator recognises contract revenue and costs in accordance with IAS 11 *Construction Contracts* and IAS 18 *Revenue*. The costs of each activity–construction, operation and resurfacing–are recognised as expenses by reference to the stage of completion of that activity. Contract revenue–the fair value of the amount due from the grantor for the activity undertaken–is recognised at the same time. Under the terms of the arrangement the operator is obliged to resurface the road at the end of year 8. In year 8 the operator will be reimbursed by the grantor for resurfacing the road. The obligation to resurface the road is measured at zero in the ~~balance sheet~~statement of financial position and the revenue and expense are not recognised in ~~the income statement~~profit or loss until the resurfacing work is performed.

IE5 The total consideration (CU200 in each of years 3–8) reflects the fair values for each of the services, which are:

Table 1.2 ***Fair values of the consideration received or receivable***

	Fair value		
Construction services	Forecast cost	+	5%
Operation services	" "	+	20%
Road resurfacing	" "	+	10%
Effective interest rate	6.18% per year		

IE6 In year 1, for example, construction costs of CU500, construction revenue of CU525 (cost plus 5 per cent), and hence construction profit of CU25 are recognised in ~~the income statement~~profit or loss.

Financial asset

IE7 The amounts due from the grantor meet the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*. The receivable is measured initially at fair value. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

IE8 If the cash flows and fair values remain the same as those forecast, the effective interest rate is 6.18 per cent per year and the receivable recognised at the end of years 1-3 will be:

Table 1.3 ***Measurement of receivable***

	CU
Amount due for construction in year 1	525
Receivable at end of year 1*	**525**
Effective interest in year 2 on receivable at the end of year 1 (6.18% x CU525)	32
Amount due for construction in year 2	525
Receivable at end of year 2	**1,082**
Effective interest in year 3 on receivable at the end of year 2 (6.18% x CU1,082)	67
Amount due for operation in year 3 (CU10 x (1+20%))	12
Cash receipts in year 3	(200)
Receivable at end of year 3	**961**

* No effective interest arises in year 1 because the cash flows are assumed to take place at the end of the year.

Overview of cash flows, ~~income statement~~statement of comprehensive income and ~~balance sheet~~statement of financial position

IE9 For the purpose of this illustration, it is assumed that the operator finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the operator's cash flows, ~~income statement~~statement of comprehensive income and ~~balance sheet~~statement of financial position over the duration of the arrangement will be:

Table 1.4 ***Cash flows*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs*	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs†	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/ (outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78

* Table 1.1

† Debt at start of year (table 1.6) x 6.7%

Table 1.5 ***~~Income statement~~Statement of comprehensive income*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue	525	525	12	12	12	12	12	122	12	12	1,256
Contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Finance income*	-	32	67	59	51	43	34	25	22	11	344
Borrowing costs†	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net profit	25	23	-	-	-	2	3	14	5	6	78

* Amount due from grantor at start of year (table 1.6) x 6.18%

† Cash/(debt) (table 1.6) x 6.7%

Table 1.6 ***~~Balance sheet~~Statement of financial position*** *(currency units)*

End of year	1	2	3	4	5	6	7	8	9	10
Amount due from grantor*	525	1,082	961	832	695	550	396	343	177	-
Cash/(debt)†	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Net assets	25	48	48	48	48	50	53	67	72	78

* Amount due from grantor at start of year, plus revenue and finance income earned in year (table 1.5), less receipts in year (table 1.4).

† Debt at start of year plus net cash flow in year (table 1.4).

IE10 This example deals with only one of many possible types of arrangements. Its purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustration as clear as possible, it has been assumed that the arrangement period is only ten years and that the operator's annual receipts are constant over that period. In practice, arrangement periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Example 2: The grantor gives the operator an intangible asset (a licence to charge users)

Arrangement terms

IE11 The terms of a service arrangement require an operator to construct a road–completing construction within two years–and maintain and operate the road to a specified standard for eight years (ie years 3-10). The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8. At the end of year 10, the service arrangement will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Table 2.1 ***Contract costs***

	Year	CU*
Construction services	1	500
	2	500
Operation services (per year)	3-10	10
Road resurfacing	8	100

* in this example, monetary amounts are denominated in 'currency units (CU) '.

IE12 The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of 200 currency units (CU200) in each of years 3-10.

IE13 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Intangible asset

IE14 The operator provides construction services to the grantor in exchange for an intangible asset, ie a right to collect tolls from road users in years 3-10. In accordance with IAS 38 *Intangible Assets*, the operator recognises the intangible asset at cost, ie the fair value of consideration transferred to acquire the asset, which is the fair value of the consideration received or receivable for the construction services delivered.

IE15 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as an intangible asset (licence to charge users of the infrastructure). The operator estimates the fair value of its consideration received to be equal to the forecast construction costs plus 5 per cent margin. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator ~~adopts the allowed alternative treatment in IAS 23 *Borrowing Costs* and therefore~~ capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase of the arrangement:

Table 2.2 ***Initial measurement of intangible asset***

	CU
Construction services in year 1 (CU500 x (1 + 5%))	525
Capitalisation of borrowing costs (table 2.4)	34
Construction services in year 2 (CU500 x (1 + 5%))	525
Intangible asset at end of year 2	1,084

IE16 In accordance with IAS 38, the intangible asset is amortised over the period in which it is expected to be available for use by the operator, ie years 3-10. The depreciable amount of the intangible asset (CU1,084) is allocated using a straight-line method. The annual amortisation charge is therefore CU1,084 divided by 8 years, ie CU135 per year.

Construction costs and revenue

IE17 The operator recognises the revenue and costs in accordance with IAS 11 *Construction Contracts*, ie by reference to the stage of completion of the construction. It measures contract revenue at the fair value of the consideration received or receivable. Thus in each of years 1 and 2 it recognises in its ~~income statement~~profit or loss construction costs of CU500, construction revenue of CU525 (cost plus 5 per cent) and, hence, construction profit of CU25.

Toll revenue

IE18 The road users pay for the public services at the same time as they receive them, ie when they use the road. The operator therefore recognises toll revenue when it collects the tolls.

Resurfacing obligations

IE19 The operator's resurfacing obligation arises as a consequence of use of the road during the operating phase. It is recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the ~~balance sheet date~~end of the reporting period.

IE20 For the purpose of this illustration, it is assumed that the terms of the operator's contractual obligation are such that the best estimate of the expenditure required to settle the obligation at any date is proportional to the number of vehicles that have used the road by that date and increases by CU17 (discounted to a current value) each year. The operator discounts the provision to its present value in accordance with IAS 37. The ~~income statement~~ charge recognised each period in profit or loss is:

Table 2.3 ***Resurfacing obligation*** *(currency units)*

Year	3	4	5	6	7	8	Total
Obligation arising in year (CU17 discounted at 6%)	12	13	14	15	16	17	87
Increase in earlier years' provision arising from passage of time	0	1	1	2	4	5	13
Total expense recognised in ~~income statement~~profit or loss	12	14	15	17	20	22	100

Overview of cash flows, ~~income statement~~statement of comprehensive income and ~~balance sheet~~statement of financial position

IE21 For the purposes of this illustration, it is assumed that the operator finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the operator's cash flows, ~~income statement~~statement of comprehensive income and ~~balance sheet~~statement of financial position over the duration of the arrangement will be:

Table 2.4 ***Cash flows*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs*	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs†	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/ (outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78

* Table 2.1

† Debt at start of year (table 2.6) x 6.7%

Table 2.5 ***~~Income statement~~Statement of comprehensive income*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue	525	525	200	200	200	200	200	200	200	200	2,650
Amortisation	-	-	(135)	(135)	(136)	(136)	(136)	(136)	(135)	(135)	(1,084)
Resurfacing expense	-	-	(12)	(14)	(15)	(17)	(20)	(22)	-	-	(100)
Other contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(1,080)
Borrowing costs†*	-	-	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(308)
Net profit	25	25	(26)	(20)	(14)	(6)	1	9	36	48	78

* Borrowing costs are capitalised during the construction phase

† Table 2.4

Table 2.6 ***~~Balance sheet~~Statement of financial position*** *(currency units)*

End of year	1	2	3	4	5	6	7	8	9	10
Intangible asset	525	1,084	949	814	678	542	406	270	135	-
Cash/(debt)*	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Resurfacing obligation	-	-	(12)	(26)	(41)	(58)	(78)	-	-	-
Net assets	25	50	24	4	(10)	(16)	(15)	(6)	30	78

* Debt at start of year plus net cash flow in year (table 2.4)

IE22 This example deals with only one of many possible types of arrangements. Its purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustration as clear as possible, it has been assumed that the arrangement period is only ten years and that the operator's annual receipts are constant over that period. In practice, arrangement periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Example 3: The grantor gives the operator a financial asset and an intangible asset

Arrangement terms

IE23 The terms of a service arrangement require an operator to construct a road–completing construction within two years–and to operate the road and maintain it to a specified standard for eight years (ie years 3-10). The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8. At the end of year 10, the arrangement will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Table 3.1 ***Contract costs***

	Year	CU*
Construction services	1	500
	2	500
Operation services (per year)	3-10	10
Road resurfacing	8	100

* in this example, monetary amounts are denominated in 'currency units' (CU).

IE24 The operator estimates the consideration in respect of construction services to be cost plus 5 per cent.

IE25 The terms of the arrangement allow the operator to collect tolls from drivers using the road. In addition, the grantor guarantees the operator a minimum amount of CU700 and interest at a specified rate of 6.18% to reflect the timing of cash receipts. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of CU200 in each of years 3-10.

IE26 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Dividing the arrangement

IE27 The contractual right to receive cash from the grantor for the services and the right to charge users for the public services should be regarded as two separate assets under IFRSs. Therefore in this arrangement it is necessary to divide the operator's consideration into two components–a financial asset component based on the guaranteed amount and an intangible asset for the remainder.

Table 3.2 ***Dividing the operator's consideration***

Year	Total	Financial asset	Intangible asset
Construction services in year 1 (CU500 × (1 + 5%))	525	350	175
Construction services in year 2 (CU500 × (1 + 5%))	525	350	175
Total construction services	1,050	700	350
	100%	*67%**	*33%*
Finance income, at specified rate of 6.18% on receivable (see table 3.3)	22	22	-
Borrowing costs capitalised (interest paid in years 1 and 2 x 33%)(see table 3.7)	11	-	11
Total fair value of the operator's consideration	1,083	722	361

* Amount guaranteed by the grantor as a proportion of the construction services

Financial asset

IE28 The amount due from or at the direction of the grantor in exchange for the construction services meets the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*. The receivable is measured initially at fair value. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

IE29 On this basis the receivable recognised at the end of years 2 and 3 will be:

Table 3.3 ***Measurement of receivable***

	CU
Construction services in year 1 allocated to the financial asset	350
Receivable at end of year 1	350
Construction services in year 2 allocated to the financial asset	350
Interest in year 2 on receivable at end of year 1 (6.18% x CU350)	22
Receivable at end of year 2	722
Interest in year 3 on receivable at end of year 2 (6.18% x CU722)	45
Cash receipts in year 3 (see table 3.5)	(117)
Receivable at end of year 3	650

Intangible asset

IE30 In accordance with IAS 38 *Intangible Assets*, the operator recognises the intangible asset at cost, ie the fair value of the consideration received or receivable.

IE31 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as a right to receive a licence to charge users of the infrastructure. The operator estimates the fair value of its consideration received or receivable as equal to the forecast construction costs plus 5 per cent. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator ~~adopts the allowed alternative treatment in IAS 23 *Borrowing Costs* and therefore~~ capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase:

Table 3.4 ***Initial measurement of intangible asset***

	CU
Construction services in year 1 (CU500 x (1 + 5%) x 33%)	175
Borrowing costs (interest paid in years 1 and 2 x 33%)(see table 3.7)	11
Construction services in year 2 (CU500 x (1 + 5%) x 33%)	175
Intangible asset at the end of year 2	361

IE32 In accordance with IAS 38, the intangible asset is amortised over the period in which it is expected to be available for use by the operator, ie years 3-10. The depreciable amount of the intangible asset (CU361 including borrowing costs) is allocated using a straight-line method. The annual amortisation charge is therefore CU361 divided by 8 years, ie CU45 per year.

Contract revenue and costs

IE33 The operator provides construction services to the grantor in exchange for a financial asset and an intangible asset. Under both the financial asset model and intangible asset model, the operator recognises contract revenue and costs in accordance with IAS 11 *Construction Contracts*, ie by reference to the stage of completion of the construction. It measures contract revenue at the fair value of the consideration receivable. Thus in each of years 1 and 2 it recognises in ~~its income statement~~profit or loss construction costs of CU500 and construction revenue of CU525 (cost plus 5 per cent).

Toll revenue

IE34 The road users pay for the public services at the same time as they receive them, ie when they use the road. Under the terms of this arrangement the cash flows are allocated to the financial asset and intangible asset in proportion, so the operator allocates the receipts from tolls between repayment of the financial asset and revenue earned from the intangible asset:

Table 3.5 ***Allocation of toll receipts***

Year	CU
Guaranteed receipt from grantor	700
Finance income (see table 3.8)	237
Total	937
Cash allocated to realisation of the financial asset per year (CU937 / 8 years)	**117**
Receipts attributable to intangible asset (CU200 x 8 years - CU937)	663
Annual receipt from intangible asset (CU663 / 8 years)	**83**

Resurfacing obligations

IE35 The operator's resurfacing obligation arises as a consequence of use of the road during the operation phase. It is recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the ~~balance sheet date~~end of the reporting period.

IE36 For the purpose of this illustration, it is assumed that the terms of the operator's contractual obligation are such that the best estimate of the expenditure required to settle the obligation at any date is proportional to the number of vehicles that have used the road by that date and increases by CU17 each year. The operator discounts the provision to its present value in accordance with IAS 37. The ~~income statement~~ charge recognised each period in profit or loss is:

Table 3.6 ***Resurfacing obligation*** *(currency units)*

Year	3	4	5	6	7	8	Total
Obligation arising in year (CU17 discounted at 6%)	12	13	14	15	16	17	87
Increase in earlier years' provision arising from passage of time	0	1	1	2	4	5	13
Total expense recognised in ~~income statement~~profit or loss	12	14	15	17	20	22	100

Overview of cash flows, ~~income statement~~statement of comprehensive income and ~~balance sheet~~statement of financial position

IE37 For the purposes of this illustration, it is assumed that the operator finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the operator's cash flows, ~~income statement~~statement of comprehensive income and ~~balance sheet~~statement of financial position over the duration of the arrangement will be:

Table 3.7 ***Cash flows*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs*	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs†	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/ (outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78

* Table 3.1

† Debt at start of year (table 3.9) x 6.7%

Table 3.8 ~~***Income statement***~~***Statement of comprehensive income*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue on construction	525	525	-	-	-	-	-	-	-	-	1,050
Revenue from intangible asset	-	-	83	83	83	83	83	83	83	83	663
Finance income*	-	22	45	40	35	30	25	19	13	7	237
Amortisation	-	-	(45)	(45)	(45)	(45)	(45)	(45)	(45)	(46)	(361)
Resurfacing expense	-	-	(12)	(14)	(15)	(17)	(20)	(22)	-	-	(100)
Construction costs	(500)	(500)									(1,000)
Other contract costs†			(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(80)
Borrowing costs (table 3.7)‡	-	(23)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(331)
Net profit	25	24	(8)	(7)	(5)	(2)	0	2	22	27	78

* Interest on receivable

† Table 3.1

‡ In year 2, borrowing costs are stated net of amount capitalised in the intangible (see table 3.4)

Table 3.9 ~~***Balance sheet***~~***Statement of financial position*** *(currency units)*

End of year	1	2	3	4	5	6	7	8	9	10
Receivable	350	722	650	573	491	404	312	214	110	-
Intangible asset	175	361	316	271	226	181	136	91	46	-
Cash/(debt)*	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Resurfacing obligation	-	-	(12)	(26)	(41)	(58)	(78)	-	-	-
Net assets	25	49	41	34	29	27	27	29	51	78

* Debt at start of year plus net cash flow in year (table 3.7)

IE38 This example deals with only one of many possible types of arrangements. Its purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustration as clear as possible, it has been assumed that the arrangement period is only ten years and that the operator's annual receipts are constant over that period. In practice, arrangement periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Appendix
Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013

In the illustrative examples accompanying IFRIC 12, paragraphs IE7 and IE28 are amended as follows:

IE7 IFRS 9 *Financial Instruments* may require the entity to measure the ~~The~~ amounts due from the grantor at amortised cost, unless the entity designates those amounts as measured at fair value through profit or loss ~~meet the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*~~. If the ~~The~~ receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and~~. It is~~ subsequently ~~measured~~ at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

IE28 IFRS 9 *Financial Instruments* may require the entity to measure the ~~The~~ amount due from or at the direction of the grantor in exchange for the construction services at amortised cost ~~meets the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*~~. If the ~~The~~ receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and~~. It is~~ subsequently ~~measured~~ at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

Basis for Conclusions on
IFRIC 12 *Service Concession Arrangements*

This Basis for Conclusions accompanies, but is not part of, IFRIC 12.

HK(IFRIC)-Int 12 is based on IFRIC Interpretation 12 *Service Concession Arrangements*. In approving HK(IFRIC)-Int 12, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 12. Accordingly, there are no significant differences between HK(IFRIC)-Int 12 and IFRIC Interpretation 12. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 12 referred to below generally correspond with those in HK(IFRIC)-Int 12.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background (paragraphs 1-3)

BC2 SIC-29 *Service Concession Arrangements: Disclosures* (formerly *Disclosure–Service Concession Arrangements*) contains disclosure requirements in respect of public-to-private service arrangements, but does not specify how they should be accounted for.

BC3 There was widespread concern about the lack of such guidance. In particular, operators wished to know how to account for infrastructure that they either constructed or acquired for the purpose of a public-to-private service concession arrangement, or were given access to for the purpose of providing the public service. They also wanted to know how to account for other rights and obligations arising from these types of arrangements.

BC4 In response to this concern, the International Accounting Standards Board asked a working group comprising representatives of the standard-setters of Australia, France, Spain and the United Kingdom (four of the countries that had expressed such concern) to carry out initial research on the subject. The working group recommended that the IFRIC should seek to clarify how certain aspects of existing accounting standards were to be applied.

BC5 In March 2005 the IFRIC published for public comment three draft Interpretations: D12 *Service Concession Arrangements–Determining the Accounting Model*, D13 *Service Concession Arrangements–The Financial Asset Model* and D14 *Service Concession Arrangements–The Intangible Asset Model*. In response to the proposals 77 comment letters were received. In addition, in order to understand better the practical issues that would have arisen on implementing the proposed Interpretations, IASB staff met various interested parties, including preparers, auditors and regulators.

BC6 Most respondents to D12-D14 supported the IFRIC's proposal to develop an Interpretation. However, nearly all respondents expressed concern with fundamental aspects of the proposals, some urging that the project be passed to the Board to develop a comprehensive standard.

BC7 In its redeliberation of the proposals the IFRIC acknowledged that the project was a large undertaking but concluded that it should continue its work because, given the limited scope of the project, it was by then better placed than the Board to deal with the issues in a timely way.

Terminology

BC8 SIC-29 used the terms 'Concession Provider' and 'Concession Operator' to describe, respectively, the grantor and operator of the service arrangement. Some commentators, and some members of the IFRIC, found these terms confusingly similar. The IFRIC decided to adopt the terms 'grantor' and 'operator', and amended SIC-29 accordingly.

Scope (paragraphs 4-9)

BC9 The IFRIC observed that public-to-private service arrangements take a variety of forms. The continued involvement of both grantor and operator over the term of the arrangement, accompanied by heavy upfront investment, raises questions over what assets and liabilities should be recognised by the operator.

BC10 The working group recommended that the scope of the IFRIC's project should be restricted to public-to-private service concession arrangements.

BC11 In developing the proposals the IFRIC decided to address only arrangements in which the grantor (a) controlled or regulated the services provided by the operator, and (b) controlled any significant residual interest in the infrastructure at the end of the term of the arrangement. It also decided to specify the accounting treatment only for infrastructure that the operator constructed or acquired from a third party, or to which it was given access by the grantor, for the purpose of the arrangement. The IFRIC concluded that these conditions were likely to be met in most of the public-to-private arrangements for which guidance had been sought.

BC12 Commentators on the draft Interpretations argued that the proposals ignored many arrangements that were found in practice, in particular, when the infrastructure was leased to the operator or, conversely, when it was held as the property, plant and equipment of the operator before the start of the service arrangement.

BC13 In considering these comments, the IFRIC decided that the scope of the project should not be expanded because it already included the arrangements most in need of interpretative guidance and expansion would have significantly delayed the Interpretation. The scope of the project was considered at length during the initial stage, as indicated above. The IFRIC confirmed its view that the proposed Interpretation should address the issues set out in paragraph 10. Nonetheless, during its redeliberation the IFRIC considered the range of typical arrangements for private sector participation in the provision of public services, including some that were outside the scope of the proposed Interpretation. The IFRIC decided that the Interpretation could provide references to relevant standards that apply to arrangements outside the scope of the Interpretation without giving guidance on their application. If experience showed that such guidance was needed, a separate project could be undertaken at a later date. Information Note 2 contains a table of references to relevant standards for the types of arrangements considered by the IFRIC.

Private-to-private arrangements

BC14 Some respondents to the draft Interpretations suggested that the scope of the proposed Interpretation should be extended to include private-to-private service arrangements. The IFRIC noted that addressing the accounting for such arrangements was not the primary purpose of the project because the IFRIC had been asked to provide guidance for public-to-private arrangements that meet the requirements set out in paragraph 5 and have the characteristics described in paragraph 3. The IFRIC noted that application by analogy would be appropriate under the hierarchy set out in paragraphs 7-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Grantor accounting

BC15 The Interpretation does not specify the accounting by grantors, because the IFRIC's objective and priority were to establish guidance for operators. Some commentators asked the IFRIC to establish guidance for the accounting by grantors. The IFRIC discussed these comments but reaffirmed its view. It noted that in many cases the grantor is a government body, and that IFRSs are not designed to apply to not-for-profit activities in the private sector, public sector or government, though entities with such activities may find them appropriate (see *Preface to IFRSs* paragraph 9).

Existing assets of the operator

BC16 The Interpretation does not specify the treatment of existing assets of the operator because the IFRIC decided that it was unnecessary to address the derecognition requirements of existing standards.

BC17 Some respondents asked the IFRIC to provide guidance on the accounting for existing assets of the operator, stating that the scope exclusion would create uncertainty about the treatment of these assets.

BC18 In its redeliberations the IFRIC noted that one objective of the Interpretation is to address whether the operator should recognise as its property, plant and equipment the infrastructure it constructs or to which it is given access. The accounting issue to be addressed for existing assets of the operator is one of derecognition, which is already addressed in IFRSs (IAS 16 *Property, Plant and Equipment*). In the light of the comments received from respondents, the IFRIC decided to clarify that certain public-to-private service arrangements may convey to the grantor a right to use existing assets of the operator, in which case the operator would apply the derecognition requirements of IFRSs to determine whether it should derecognise its existing assets.

The significant residual interest criterion

BC19 Paragraph 5(b) of D12 proposed that for a service arrangement to be within its scope the residual interest in the infrastructure handed over to the grantor at the end of the arrangement must be significant. Respondents argued, and the IFRIC agreed, that the significant residual interest criterion would limit the usefulness of the guidance because a service arrangement for the entire physical life of the infrastructure would be excluded from the scope of the guidance. That result was not the IFRIC's intention. In its redeliberation of the proposals, the IFRIC decided that it would not retain the proposal that the residual interest in the infrastructure handed over to the grantor at the end of the arrangement must be significant. As a consequence, 'whole of life' infrastructure (ie where the infrastructure is used in a public-to-private service arrangement for the entirety of its useful life) is within the scope of the Interpretation.

Treatment of the operator's rights over the infrastructure (paragraph 11)

BC20 The IFRIC considered the nature of the rights conveyed to the operator in a service concession arrangement. It first examined whether the infrastructure used to provide public services could be classified as property, plant and equipment of the operator under IAS 16. It started from the principle that infrastructure used to provide public services should be recognised as property, plant and equipment of the party that controls its use. This principle determines which party should recognise the property, plant and equipment as its own. The reference to control stems from the *Framework*:

(a) an asset is defined by the *Framework* as 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'

(b) the *Framework* notes that many assets are associated with legal rights, including the right of ownership. It goes on to clarify that the right of ownership is not essential.

(c) rights are often unbundled. For example, they may be divided proportionately (undivided interests in land) or by specified cash flows (principal and interest on a bond) or over time (a lease).

BC21 The IFRIC concluded that treatment of infrastructure that the operator constructs or acquires or to which the grantor gives the operator access for the purpose of the service arrangement should be determined by whether it is controlled by the grantor in the manner described in paragraph 5. If it is so controlled (as will be the case for all arrangements within the scope of the Interpretation), then, regardless of which party has legal title to it during the arrangement, the infrastructure should not be recognised as property, plant and equipment of the operator because the operator does not control the use of the public service infrastructure.

BC22 In reaching this conclusion the IFRIC observed that it is control of the right to use an asset that determines recognition under IAS 16 and the creation of a lease under IAS 17 *Leases*. IAS 16 defines property, plant and equipment as tangible items that 'are held for use in the production or supply of goods or services, for rental to others or for administrative purposes …'. It requires items within this definition to be recognised as property, plant and equipment unless another standard requires or permits a different approach. As an example of a different approach, it highlights the requirement in IAS 17 for recognition of leased property, plant and equipment to be evaluated on the basis of the transfer of risks and rewards. That standard defines a lease as 'an agreement whereby the lessor conveys to the lessee in return for a series of payments the right to use an asset' and it sets out the requirements for classification of leases. IFRIC 4 *Determining whether an Arrangement contains a Lease* interprets the meaning of right to use an asset as 'the arrangement conveys the right to control the use of the underlying asset.'

BC23 Accordingly, it is only if an arrangement conveys the right to control the use of the underlying asset that reference is made to IAS 17 to determine how such a lease should be classified. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

BC24 The IFRIC considered whether arrangements within the scope of IFRIC 12 convey 'the right to control the use of the underlying asset' (the public service infrastructure) to the operator. The IFRIC decided that, if an arrangement met the conditions in paragraph 5, the operator would not have the right to control the use of the underlying asset and should therefore not recognise the infrastructure as a leased asset.

BC25 In arrangements within the scope of the Interpretation the operator acts as a service provider. The operator constructs or upgrades infrastructure used to provide a public service. Under the terms of the contract the operator has access to operate the infrastructure to provide the public service on the grantor's behalf. The asset recognised by the operator is the consideration it receives in exchange for its services, not the public service infrastructure that it constructs or upgrades.

BC26 Respondents to the draft Interpretations disagreed that recognition should be determined solely on the basis of control of use without any assessment of the extent to which the operator or the grantor bears the risks and rewards of ownership. They questioned how the proposed approach could be reconciled to IAS 17, in which the leased asset is recognised by the party that bears substantially all the risks and rewards incidental to ownership.

BC27 During its redeliberation the IFRIC affirmed its decision that if an arrangement met the control conditions in paragraph 5 of the Interpretation the operator would not have the right to control the use of the underlying asset (public service infrastructure) and should therefore not recognise the infrastructure as its property, plant and equipment under IAS 16 or the creation of a lease under IAS 17. The contractual service arrangement between the grantor and operator would not convey the right to use the infrastructure to the operator. The IFRIC concluded that this treatment is also consistent with IAS 18 *Revenue* because, for arrangements within the scope of the Interpretation, the second condition of paragraph 14 of IAS 18 is not satisfied. The grantor retains continuing managerial involvement to the degree usually associated with ownership and control over the infrastructure as described in paragraph 5.

BC28 In service concession arrangements rights are usually conveyed for a limited period, which is similar to a lease. However, for arrangements within the scope of the Interpretation, the operator's right is different from that of a lessee: the grantor retains control over the use to which the infrastructure is put, by controlling or regulating what services the operator must provide, to whom it must provide them, and at what price, as described in paragraph 5(a). The grantor also retains control over any significant residual interest in the infrastructure throughout the period of the arrangement. Unlike a lessee, the operator does not have a right of use of the underlying asset: rather it has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

BC29 The IFRIC considered whether the scope of the Interpretation might overlap with IFRIC 4. In particular, it noted the views expressed by some respondents that the contractual terms of certain service arrangements would be regarded as leases under IFRIC 4 and would also be regarded as meeting the scope criterion set out in paragraph 5 of IFRIC 12. The IFRIC did not regard the choice between accounting treatments as appropriate because it could lead to different accounting treatments for contracts that have similar economic effects. In the light of comments received the IFRIC amended the scope of IFRIC 4 to specify that if a service arrangement met the scope requirements of IFRIC 12 it would not be within the scope of IFRIC 4.

Recognition and measurement of arrangement consideration (paragraphs 12 and 13)

BC30 The accounting requirements for construction and service contracts are addressed in IAS 11 *Construction Contracts* and IAS 18. They require revenue to be recognised by reference to the stage of completion of the contract activity. IAS 18 states the general principle that revenue is measured at the fair value of the consideration received or receivable. However, the IFRIC observed that the fair value of the construction services delivered may in practice be the most appropriate method of establishing the fair value of the consideration received or receivable for the construction services. This will be the case in service concession arrangements, because the consideration attributable to the construction activity often has to be apportioned from a total sum receivable on the contract as a whole and, if it consists of an intangible asset, may also be subject to uncertainty in measurement.

BC31 The IFRIC noted that IAS 18 requires its recognition criteria to be applied separately to identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and is recognised as revenue over the period during which the service is performed. The IFRIC concluded that this requirement was relevant to service arrangements within the scope of the Interpretation. Arrangements within the scope of the Interpretation involve an operator providing more than one service, ie construction or upgrade services, and operation services. Although the contract for each service is generally negotiated as a single contract, its terms call for separate phases or elements because each separate phase or element has its own distinct skills, requirements and risks. The IFRIC noted that, in these circumstances, IAS 18 paragraphs 4 and 13 require the contract to be separated into two separate phases or elements, a construction element within the scope of IAS 11 and an operations element within the scope of IAS 18. Thus the operator might report different profit margins on each phase or element. The IFRIC noted that the amount for each service would be identifiable because such services were often provided as a single service. The IFRIC also noted that the combining and segmenting criteria of IAS 11 applied only to the construction element of the arrangement.

BC32 In some circumstances, the grantor makes a non-cash payment for the construction services, ie it gives the operator an intangible asset (a right to charge users of the public service) in exchange for the operator providing construction services. The operator then uses the intangible asset to generate further revenues from users of the public service.

BC33 Paragraph 12 of IAS 18 states:

> When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

BC34 The IFRIC noted that total revenue does not equal total cash inflows. The reason for this outcome is that, when the operator receives an intangible asset in exchange for its construction services, there are two sets of inflows and outflows rather than one. In the first set, the construction services are exchanged for the intangible asset in a barter transaction with the grantor. In the second set, the intangible asset received from the grantor is used up to generate cash flows from users of the public service. This result is not unique to service arrangements within the scope of the Interpretation. Any situation in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues would lead to a similar result.

BC35 Some IFRIC members were uncomfortable with such a result, and would have preferred a method of accounting under which total revenues were limited to the cash inflows. However, they accepted that it is consistent with the treatment accorded to a barter transaction, ie an exchange of dissimilar goods or services.

Consideration given by the grantor to the operator (paragraphs 14–19)

BC36 The IFRIC observed that the contractual rights that the operator receives in exchange for providing construction services can take a variety of forms. They are not necessarily rights to receive cash or other financial assets.

BC37 The draft Interpretations proposed that the nature of the operator's asset depended on who had the primary responsibility to pay the operator for the services. The operator should recognise a financial asset when the grantor had the primary responsibility to pay the operator for the services. The operator should recognise an intangible asset in all other cases.

BC38 Respondents to the draft Interpretations argued that determining which accounting model to apply by looking at who has the primary responsibility to pay the operator for the services, irrespective of who bears demand risk (ie ability and willingness of users to pay for the service), would result in an accounting treatment that did not reflect the economic substance of the arrangement. Respondents were concerned that the proposal would require operators with essentially identical cash flow streams to adopt different accounting models. This would impair users' understanding of entities involved in providing public-to-private service concession arrangements. Several gave the example of a shadow toll road and a toll road, where the economics (demand risk) of the arrangements would be similar, pointing out that under the proposals the two arrangements would be accounted for differently. In the light of comments received on the proposals, the IFRIC decided to clarify (see paragraphs 15-19) the extent to which an operator should recognise a financial asset and an intangible asset.

BC39 Responses to the draft Interpretations provided only limited information about the impact of the proposals. To obtain additional information, IASB staff arranged for discussions with preparers, auditors and regulators. The consensus of those consulted was that the identity of the payee has no effect on the risks to the operator's cash flow stream. The operator typically relies on the terms of the service arrangement contract to determine the risks to its cash flow stream. The operator's cash flows may be guaranteed by the grantor, in which case the grantor bears demand risk, or the operator's cash flows may be conditional on usage levels, in which case the operator bears demand risk.

BC40 The IFRIC noted that the operator's cash flows are guaranteed when (a) the grantor agrees to pay the operator specified or determinable amounts whether or not the public service is used (sometimes known as take-or-pay arrangements) or (b) the grantor grants a right to the operator to charge users of the public service and the grantor guarantees the operator's cash flows by way of a shortfall guarantee described in paragraph 16. The operator's cash flows are conditional on usage when it has no such guarantee but must obtain its revenue either directly from users of the public service or from the grantor in proportion to public usage of the service (road tolls or shadow tolls for example).

A financial asset (operator's cash flows are guaranteed by the grantor)

BC41 Paragraph 11 of IAS 32 *Financial Instruments: Presentation* defines a financial asset to include 'a contractual right to receive cash or another financial asset from another entity'. Paragraph 13 of that standard clarifies that 'contractual' refers to 'an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law.'

BC42 The IFRIC decided that a financial asset should be recognised to the extent that the operator has an unconditional present right to receive cash from or at the direction of the grantor for the construction services; and the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has a contractual right to receive cash for the construction services if the grantor contractually guarantees the operator's cash flows, in the manner described in paragraph 16. The IFRIC noted that the operator has an unconditional right to receive cash to the extent that the grantor bears the risk (demand risk) that the cash flows generated by the users of the public service will not be sufficient to recover the operator's investment.

BC43 The IFRIC noted that:

(a) an agreement to pay for the shortfall, if any, between amounts received from users of the service and specified or determinable amounts does not meet the definition of a financial guarantee in paragraph 9 of IAS 39 *Financial Instruments: Recognition and Measurement* because the operator has an unconditional contractual right to receive cash from the grantor. Furthermore, the amendments made to IAS 39 in August 2005 by *Financial Guarantee Contracts* do not address the treatment of financial guarantee contracts by the holder. The objective of the amendments was to ensure that issuers of financial guarantee contracts recognise a liability for the obligations the guarantor has undertaken in issuing that guarantee.

(b) users or the grantor may pay the contractual amount receivable directly to the operator. The method of payment is a matter of form only. In both cases the operator has a present, unconditional, contractual right to receive the specified or determinable cash flows from or at the direction of the grantor. The nature of the operator's asset is not altered solely because the contractual amount receivable may be paid directly by users of the public service. The IFRIC observed that accounting for these contractual cash flows in accordance with IASs 32 and 39 faithfully reflects the economics of the arrangements, which is to provide finance to the grantor for the construction of the infrastructure.

Operator's cash flows are contingent on the operator meeting specified quality or efficiency requirements

BC44 The IFRIC concluded that the definition of a financial asset is met even if the contractual right to receive cash is contingent on the operator meeting specified quality or efficiency requirements or targets. Before the grantor is required to pay the operator for its construction services, the operator may have to ensure that the infrastructure is capable of generating the public services specified by the grantor or that the infrastructure is up to or exceeds operating standards or efficiency targets specified by the grantor to ensure a specified level of service and capacity can be delivered. In this respect the operator's position is the same as that of any other entity in which payment for goods or services is contingent on subsequent performance of the goods or service sold.

BC45 Therefore IFRIC 12 treats the consideration given by the grantor to the operator as giving rise to a financial asset irrespective of whether the contractual amounts receivable are contingent on the operator meeting levels of performance or efficiency targets.

An intangible asset (operator's cash flows are conditional on usage)

BC46 IAS 38 *Intangible Assets* defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It mentions licences as examples of intangible assets. It describes an asset as being identifiable when it arises from contractual rights.

BC47 The IFRIC concluded that the right of an operator to charge users of the public service meets the definition of an intangible asset, and therefore should be accounted for in accordance with IAS 38. In these circumstances the operator's revenue is conditional on usage and it bears the risk (demand risk) that the cash flows generated by users of the public service will not be sufficient to recover its investment.

BC48 In the absence of contractual arrangements designed to ensure that the operator receives a minimum amount (see paragraphs BC53 and BC54), the operator has no contractual right to receive cash even if receipt of the cash is highly probable. Rather, the operator has an opportunity to charge those who use the public service in the future. The operator bears the demand risk and hence its commercial return is contingent on users using the public service. The operator's asset is a licence, which would be classified as an intangible asset within the scope of IAS 38. And, as clarified in paragraph AG10 of the application guidance in IAS 32:

> Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

BC49 The IFRIC considered whether a right to charge users unsupported by any shortfall guarantee from the grantor could be regarded as an indirect right to receive cash arising from the contract with the grantor. It concluded that although the operator's asset might have characteristics that are similar to those of a financial asset, it would not meet the definition of a financial asset in IAS 32: the operator would not at the balance sheet date have a contractual right to receive cash from another entity. That other entity (ie the user) would still have the ability to avoid any obligation. The grantor would be passing to the operator an opportunity to charge users in future, not a present right to receive cash.

Contractual arrangements that eliminate substantially all variability in the operator's return

BC50 The IFRIC considered whether agreements incorporating contractual arrangements designed to eliminate substantially all variability in the operator's return would meet the definition of a financial asset, for example:

(a) the price charged by the operator would be varied by regulation designed to ensure that the operator received a substantially fixed return; or

(b) the operator would be permitted to collect revenues from users or the grantor until it achieved a specified return on its investment, at which point the arrangement would come to an end.

BC51 The IFRIC noted that, as a result of such contractual arrangements, the operator's return would be low risk. Only if usage were extremely low would the contractual mechanisms fail to give the operator the specified return. The likelihood of usage being that low could be remote. Commercially, the operator's return would be regarded as fixed, giving its asset many of the characteristics of a financial asset.

BC52 However, the IFRIC concluded that the fact that the operator's asset was low risk did not influence its classification. IAS 32 does not define financial assets by reference to the amount of risk in the return–it defines them solely by reference to the existence or absence of an unconditional contractual right to receive cash. There are other examples of licences that offer the holders of the rights predictable, low risk returns, but such licences are not regarded as giving the holder a contractual right to cash. And there are other industries in which price regulation is designed to provide the operators with substantially fixed returns–but the rights of operators in these other industries are not classified as financial assets as a result. The operator's asset is a variable term licence, which would be classified as an intangible asset within the scope of IAS 38.

A financial asset and an intangible asset

BC53 The IFRIC concluded that if the operator is paid for its construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The IFRIC included the requirement to account separately for each component (sometimes known as a bifurcated arrangement) of the operator's consideration in response to a concern raised on the draft Interpretations. The concern was that, in some arrangements, both parties to the contract share the risk (demand risk) that the cash flows generated by users of the public service will not be sufficient to recover the operator's investment. In order to achieve the desired sharing of risk, the parties often agree to arrangements under which the grantor pays the operator for its services partly by a financial asset and partly by granting a right to charge users of the public service (an intangible asset). The IFRIC concluded that in these circumstances it would be necessary to divide the operator's consideration into a financial asset component for any guaranteed amount of cash or other financial asset and an intangible asset for the remainder.

BC54 The IFRIC concluded that the nature of consideration given by the grantor to the operator is determined by reference to the contract terms and when it exists, relevant contract law. The IFRIC noted public-to-private service agreements are rarely if ever the same; technical requirements vary by sector and country. Furthermore, the terms of the contractual agreement may also depend on the specific features of the overall legal framework of the particular country. Public-to-private service contract laws, where they exist, may contain terms that do not have to be repeated in individual contracts.

Contractual obligations to restore the infrastructure to a specified level of serviceability (paragraph 21)

BC55 The IFRIC noted that IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* prohibits an entity from providing for the replacement of parts of its own property, plant and equipment. IAS 16 requires such costs to be recognised in the carrying amount of an item of property, plant and equipment if the recognition criteria in paragraph 7 are met. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately. The IFRIC concluded that this prohibition would not apply to arrangements within the scope of the Interpretation because the operator does not recognise the infrastructure as its own property, plant and equipment. The operator has an unavoidable obligation that it owes to a third party, the grantor, in respect of the infrastructure. The operator should recognise its obligations in accordance with IAS 37.

BC56 The IFRIC considered whether the Interpretation should contain guidance on the timing of recognition of the obligations. It noted that the precise terms and circumstances of the obligations would vary from contract to contract. It concluded that the requirements and guidance in IAS 37 were sufficiently clear to enable an operator to identify the period(s) in which different obligations should be recognised.

Borrowing costs (paragraph 22)

BC57 IAS 23 *Borrowing Costs* permits borrowing costs to be capitalised as part of the cost of a qualifying asset to the extent that they are directly attributable to its acquisition, construction or production until the asset is ready for its intended use or sale.* That Standard defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

BC58 For arrangements within the scope of the Interpretation, the IFRIC decided that an intangible asset (ie the grantor gives the operator a right to charge users of the public service in return for construction services) meets the definition of a qualifying asset of the operator because generally the licence would not be ready for use until the infrastructure was constructed or upgraded. A financial asset (ie the grantor gives the operator a contractual right to receive cash or other financial asset in return for construction services) does not meet the definition of a qualifying asset of the operator. The IFRIC observed that interest is generally accreted on the carrying value of financial assets.

BC59 The IFRIC noted that financing arrangements may result in an operator obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditure relating to construction or operation services. In such circumstances the funds are often temporarily invested. Any investment income earned on such funds is recognised in accordance with IAS 39, unless the operator adopts the allowed alternative treatment, in which case investment income earned during the construction phase of the arrangement is accounted for in accordance with paragraph 16 of IAS 23.*

Financial asset (paragraphs 23 – 25)

BC60 Paragraph 9 of IAS 39 identifies and defines four categories of financial asset: (i) those held at fair value through profit or loss; (ii) held-to-maturity investments; (iii) loans and receivables; and (iv) available-for-sale financial assets.

* In March 2007, IAS 23 was revised to require the previously allowed alternative treatment of capitalisation. Therefore, an entity is required to capitalise borrowing costs as part of the cost of a qualifying asset to the extent that they are directly attributable to its acquisition, construction or production until the asset is ready for its intended use or sale. That revision does not affect the reasoning set out in this Basis for Conclusions.

BC61 Paragraph 24 of IFRIC 12 assumes that public-to-private service arrangement financial assets will not be categorised as held-to-maturity investments. Paragraph 9 of IAS 39 states that a financial asset may not be classified as a held-to-maturity investment if it meets the definition of a loan or receivable. An asset that meets the definition of a held-to-maturity investment will meet the definition of a loan or receivable unless:

(a) it is quoted in an active market; or

(b) the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

It is not envisaged that a public-to-private service arrangement financial asset will be quoted in an active market. Hence the circumstances of (a) will not arise. In the circumstances of (b), the asset must be classified as available for sale (if not designated upon initial recognition as at fair value through profit or loss).

BC62 The IFRIC considered whether the contract would include an embedded derivative if the amount to be received by the operator could vary with the quality of subsequent services to be provided by the operator or performance or efficiency targets to be achieved by the operator. The IFRIC concluded that it would not, because the definition of a derivative in IAS 39 requires, among other things, that the variable is not specific to a party to the contract. The consequence is that the contract's provision for variations in payments does not meet the definition of a derivative and, accordingly, the requirements of IAS 39 in relation to embedded derivatives do not apply. The IFRIC observed that if the amount to be received by the operator is conditional on the infrastructure meeting quality or performance or efficiency targets as described in paragraph BC44, this would not prevent the amount from being classified as a financial asset. The IFRIC also concluded that during the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) should be classified as a financial asset when it represents cash or another financial asset due from or at the direction of the grantor.

Intangible asset (paragraph 26)

BC63 The Interpretation requires the operator to account for its intangible asset in accordance with IAS 38. Among other requirements, IAS 38 requires an intangible asset with a finite useful economic life to be amortised over that life. Paragraph 97 states that 'the amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.'

BC64 The IFRIC considered whether it would be appropriate for intangible assets under paragraph 26 to be amortised using an 'interest' method of amortisation, ie one that takes account of the time value of money in addition to the consumption of the intangible asset, treating the asset more like a monetary than a non-monetary asset. However, the IFRIC concluded that there was nothing unique about these intangible assets that would justify use of a method of depreciation different from that used for other intangible assets. The IFRIC noted that paragraph 98 of IAS 38 provides for a number of amortisation methods for intangible assets with finite useful lives. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

BC65 The IFRIC noted that interest methods of amortisation are not permitted under IAS 38. Therefore, IFRIC 12 does not provide exceptions to permit use of interest methods of amortisation.

BC66 The IFRIC considered when the operator should first recognise the intangible asset. The IFRIC concluded that the intangible asset (the licence) received in exchange for construction services should be recognised in accordance with general principles applicable to contracts for the exchange of assets or services.

BC67 The IFRIC noted that it is current practice not to recognise executory contracts to the extent that they are unperformed by both parties (unless the contract is onerous). IAS 37 describes executory contracts as 'contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent'. Paragraph 91 of the *Framework* states:

> In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements.

BC68 Therefore, the IFRIC concluded that contracts within the scope of the Interpretation should not be recognised to the extent that they are executory. The IFRIC noted that service concession arrangements within the scope of the Interpretation are generally executory when the contracts are signed. The IFRIC also concluded that during the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) should be classified as an intangible asset to the extent that it represents a right to receive a right (licence) to charge users of the public service (an intangible asset).

Items provided to the operator by the grantor (paragraph 27)

BC69 For service arrangements within the scope of the Interpretation, pre-existing infrastructure items made available to the operator by the grantor for the purpose of the service arrangement are not recognised as property, plant and equipment of the operator.

BC70 However, different considerations apply to other assets provided to the operator by the grantor if the operator can keep or deal with the assets as it wishes. Such assets become assets of the operator and so should be accounted for in accordance with general recognition and measurement principles, as should the obligations undertaken in exchange for them.

BC71 The IFRIC considered whether such assets would represent government grants, as defined in paragraph 3 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*:

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

The IFRIC concluded that if such assets were part of the overall consideration payable by the grantor on an arms' length basis for the operator's services, they would not constitute 'assistance'. Therefore, they would not meet the definition of government grants in IAS 20 and that standard would not apply.

Transition (paragraphs 29 and 30)

BC72 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that an entity shall account for a change in accounting policy resulting from initial application of an Interpretation in accordance with any specific transitional provisions in that Interpretation. In the absence of any specific transitional provisions, the general requirements of IAS 8 apply. The general requirement in IAS 8 is that the changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable.

BC73 The IFRIC noted that there are two aspects to retrospective determination: reclassification and remeasurement. The IFRIC took the view that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in an operator's balance sheet, but that retrospective remeasurement of service arrangement assets might not always be practicable.

BC74 The IFRIC noted that, when retrospective restatement is not practicable, IAS 8 requires prospective application from the earliest practicable date, which could be the start of the current period. Under prospective application, the operator could be applying different accounting models to similar transactions, which the IFRIC decided would be inappropriate. The IFRIC regarded it as important that the correct accounting model should be consistently applied.

BC75 The Interpretation reflects these conclusions.

Amendments to IFRS 1

BC76 The amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* are necessary to ensure that the transitional arrangements are available to both existing users and first-time adopters of IFRSs. The IFRIC believes that the requirements will ensure that the balance sheet will exclude any items that would not qualify for recognition as assets and liabilities under IFRSs.

Summary of changes from the draft Interpretations

BC77 The main changes from the IFRIC's proposals are as follows:

(a) The proposals were published in three separate draft Interpretations, D12 *Service Concession Arrangements–Determining the Accounting Model*, D13 *Service Concession Arrangements–The Financial Asset Model* and D14 *Service Concession Arrangements–The Intangible Asset Model*. In finalising IFRIC 12, the IFRIC combined the three draft Interpretations.

(b) By contrast with IFRIC 12 the draft Interpretations did not explain the reasons for the scope limitations and the reasons for the control approach adopted by the IFRIC in paragraph 5. The IFRIC added Information Note 2 to IFRIC 12 to provide references to standards that apply to arrangements outside the scope of the Interpretation.

(c) The scope of the proposals did not include 'whole of life infrastructure' (ie infrastructure used in a public-to-private service arrangement for its entire useful life). IFRIC 12 includes 'whole of life infrastructure' within its scope.

(d) Under the approach proposed, an entity determined the appropriate accounting model by reference to whether the grantor or the user had primary responsibility to pay the operator for the services provided. IFRIC 12 requires an entity to recognise a financial asset to the extent that the operator has an unconditional contractual right to receive cash from or at the direction of the grantor. The operator should recognise an intangible asset to the extent that it receives a right to charge users of the public service.

(e) By contrast with IFRIC 12, the draft Interpretations implied that the nature of asset recognised (a financial asset or an intangible asset) by the operator as consideration for providing construction services determined the accounting for the operation phase of the arrangement.

(f) Under the approach proposed in the draft Interpretations, an entity could capitalise borrowing costs under the allowed alternative treatment in IAS 23. IFRIC 12 requires borrowing costs to be recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service), in which case borrowing costs attributable to the arrangement may be capitalised in accordance with the allowed alternative treatment under IAS 23.*

(g) In finalising IFRIC 12, the IFRIC decided to amend IFRIC 4.

* In March 2007, IAS 23 was revised to require the previously allowed alternative treatment of capitalisation. Therefore, an entity is required to capitalise borrowing costs as part of the cost of a qualifying asset to the extent that they are directly attributable to its acquisition, construction or production until the asset is ready for its intended use or sale. That revision does not affect the reasoning set out in this Basis for Conclusions.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 9 *Financial Instruments* (issued in November 2009) - effective for annual periods beginning on or after 1 January 2013

The Basis for Conclusions on IFRIC 12 is amended as described below.

In paragraph BC59 the reference to 'IAS 39' is footnoted as follows:

* In November 2009 the IASB 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*. IFRS 9 applies to all assets within the scope of IAS 39.

The heading above paragraph BC60 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 for the classification of assets within the scope of IAS 39. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 12 was issued.

HK(IFRIC)-Int 15
~~Issued August 2008~~Revised August 2010

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

HK(IFRIC) Interpretation 15

Agreements for the Construction of Real Estate

* HK(IFRIC)-Int 15 is applicable for annual periods beginning on or after 1 January 2009. Earlier application is permitted. HK(IFRIC)-Int 15 supersedes HK Interpretation 3 issued in 2005 as revised in 2006.

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

CONTENTS

paragraphs

Hong Kong (IFRIC) INTERPRETATION 15
AGREEMENTS FOR THE CONSTRUCTION OF REAL ESTATE

Hong Kong (IFRIC) Interpretation 15 *Agreements for the Construction of Real Estate* (HK(IFRIC)-Int 15) is set out in paragraphs 1–25. HK(IFRIC)-Int 15 is accompanied by an information note, illustrative examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 15
Agreements for the Construction of Real Estate

References

- HKAS 1 *Presentation of Financial Statements* (as revised in 2007)
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 11 *Construction Contracts*
- HKAS 18 *Revenue*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- HK(IFRIC)-Int 12 *Service Concession Arrangements*
- HK(IFRIC)-Int 13 *Customer Loyalty Programmes*

Background

1 In the real estate industry, entities that undertake the construction of real estate, directly or through subcontractors, may enter into agreements with one or more buyers before construction is complete. Such agreements take diverse forms.

2 For example, entities that undertake the construction of residential real estate may start to market individual units (apartments or houses) 'off plan', ie while construction is still in progress, or even before it has begun. Each buyer enters into an agreement with the entity to acquire a specified unit when it is ready for occupation. Typically, the buyer pays a deposit to the entity that is refundable only if the entity fails to deliver the completed unit in accordance with the contracted terms. The balance of the purchase price is generally paid to the entity only on contractual completion, when the buyer obtains possession of the unit.

3 Entities that undertake the construction of commercial or industrial real estate may enter into an agreement with a single buyer. The buyer may be required to make progress payments between the time of the initial agreement and contractual completion. Construction may take place on land the buyer owns or leases before construction begins.

Scope

4 This Interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.

5 Agreements in the scope of this Interpretation are agreements for the construction of real estate. In addition to the construction of real estate, such agreements may include the delivery of other goods or services.

Issues

6 The Interpretation addresses two issues:

(a) Is the agreement within the scope of HKAS 11 or HKAS 18?

(b) When should revenue from the construction of real estate be recognised?

Conclusions

7 The following discussion assumes that the entity has previously analysed the agreement for the construction of real estate and any related agreements and concluded that it will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed real estate to an extent that would preclude recognition of some or all of the consideration as revenue. If recognition of some of the consideration as revenue is precluded, the following discussion applies only to the part of the agreement for which revenue will be recognised.

8 Within a single agreement, an entity may contract to deliver goods or services in addition to the construction of real estate (eg a sale of land or provision of property management services). In accordance with paragraph 13 of HKAS 18, such an agreement may need to be split into separately identifiable components including one for the construction of real estate. The fair value of the total consideration received or receivable for the agreement shall be allocated to each component. If separate components are identified, the entity applies paragraphs 10-12 of this Interpretation to the component for the construction of real estate in order to determine whether that component is within the scope of HKAS 11 or HKAS 18. The segmenting criteria of HKAS 11 then apply to any component of the agreement that is determined to be a construction contract.

9 The following discussion refers to an agreement for the construction of real estate but it also applies to a component for the construction of real estate identified within an agreement that includes other components.

Determining whether the agreement is within the scope of HKAS 11 or HKAS 18

10 Determining whether an agreement for the construction of real estate is within the scope of HKAS 11 or HKAS 18 depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement with respect to each agreement.

11 HKAS 11 applies when the agreement meets the definition of a construction contract set out in paragraph 3 of HKAS 11: ‘a contract specifically negotiated for the construction of an asset or a combination of assets …’ An agreement for the construction of real estate meets the definition of a construction contract when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability). When HKAS 11 applies, the construction contract also includes any contracts or components for the rendering of services that are directly related to the construction of the real estate in accordance with paragraph 5(a) of HKAS 11 and paragraph 4 of HKAS 18.

12 In contrast, an agreement for the construction of real estate in which buyers have only limited ability to influence the design of the real estate, eg to select a design from a range of options specified by the entity, or to specify only minor variations to the basic design, is an agreement for the sale of goods within the scope of HKAS 18.

Accounting for revenue from the construction of real estate

The agreement is a construction contract

13 When the agreement is within the scope of HKAS 11 and its outcome can be estimated reliably, the entity shall recognise revenue by reference to the stage of completion of the contract activity in accordance with HKAS 11.

14 The agreement may not meet the definition of a construction contract and therefore be within the scope of HKAS 18. In this case, the entity shall determine whether the agreement is for the rendering of services or for the sale of goods.

The agreement is an agreement for the rendering of services

15 If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services in accordance with HKAS 18. In this case, if the criteria in paragraph 20 of HKAS 18 are met, HKAS 18 requires revenue to be recognised by reference to the stage of completion of the transaction using the percentage of completion method. The requirements of HKAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction (HKAS 18 paragraph 21).

The agreement is an agreement for the sale of goods

16 If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue set out in paragraph 14 of HKAS 18 apply.

17 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. In this case, if all the criteria in paragraph 14 of HKAS 18 are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method. The requirements of HKAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction.

18 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (eg at completion, upon or after delivery). In this case, the entity shall recognise revenue only when all the criteria in paragraph 14 of HKAS 18 are satisfied.

19 When the entity is required to perform further work on real estate already delivered to the buyer, it shall recognise a liability and an expense in accordance with paragraph 19 of HKAS 18. The liability shall be measured in accordance with HKAS 37. When the entity is required to deliver further goods or services that are separately identifiable from the real estate already delivered to the buyer, it would have identified the remaining goods or services as a separate component of the sale, in accordance with paragraph 8 of this Interpretation.

Disclosures

20 When an entity recognises revenue using the percentage of completion method for agreements that meet all the criteria in paragraph 14 of HKAS 18 continuously as construction progresses (see paragraph 17 of the Interpretation), it shall disclose:

(a) how it determines which agreements meet all the criteria in paragraph 14 of HKAS 18 continuously as construction progresses;

(b) the amount of revenue arising from such agreements in the period; and

(c) the methods used to determine the stage of completion of agreements in progress.

21 For the agreements described in paragraph 20 that are in progress at the reporting date, the entity shall also disclose:

(a) the aggregate amount of costs incurred and recognised profits (less recognised losses) to date; and

(b) the amount of advances received.

Amendments to the ~~appendix to~~illustrative examples accompanying HKAS 18

~~22 This Interpretation supersedes the real estate guidance (Example 9) in the appendix to HKAS 18.~~

~~23 The appendix to HKAS 18 is amended as described below.~~

~~All of the text under the heading '9 *Real estate sales*.' is deleted.~~

~~New text is inserted under the heading as follows:~~

~~'This example has been superseded by Hong Kong (IFRIC) Interpretation 15 *Agreements for the Construction of Real Estate*.'~~

22-23 [Amendments incorporated in the illustrative examples accompanying HKAS 18]

Effective date and transition

24 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the Interpretation for a period beginning before 1 January 2009, it shall disclose that fact.

25 Changes in accounting policy shall be accounted for retrospectively in accordance with HKAS 8.

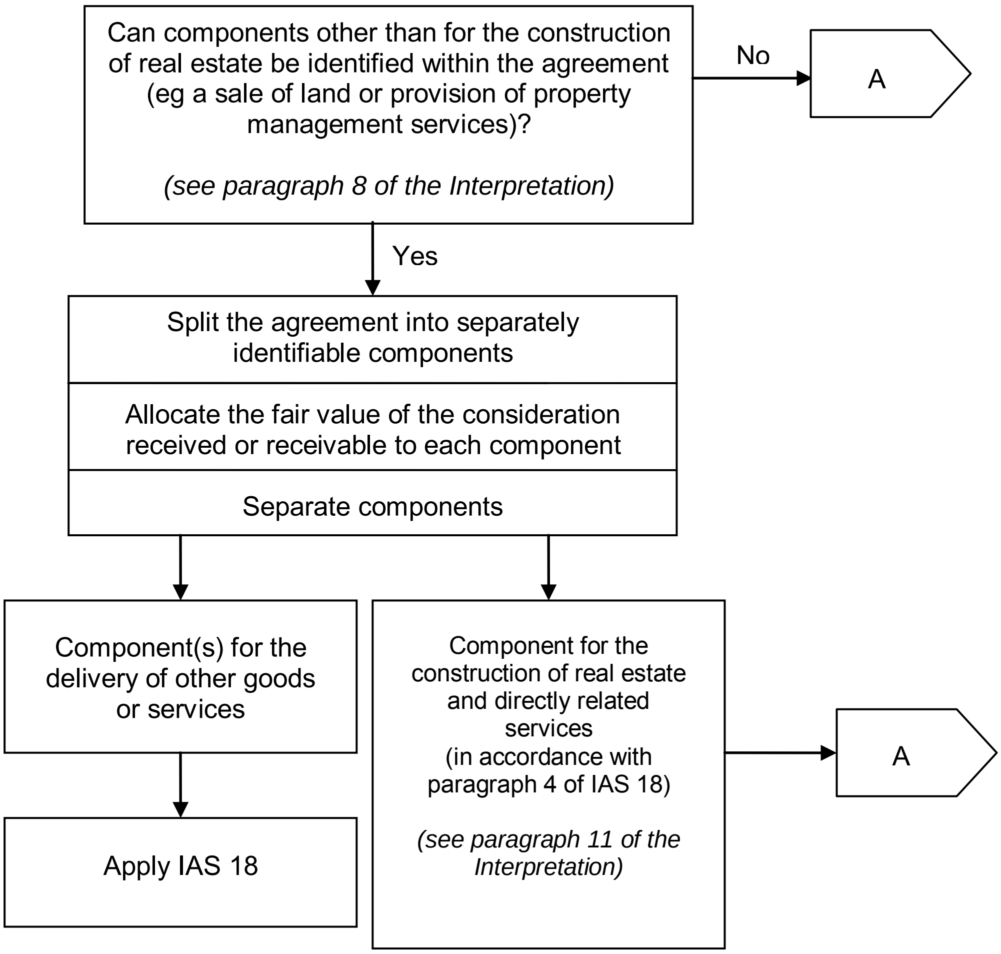
Withdrawal of HK Interpretation 3

26 This Interpretation supersedes HK Interpretation 3 *Revenue – Pre-completion Contracts for the Sale of Development Properties* issued in 2005 as amended in 2006.

Information note

Analysis of a single agreement for the construction of real estate

This note accompanies, but is not part of, IFRIC 15.



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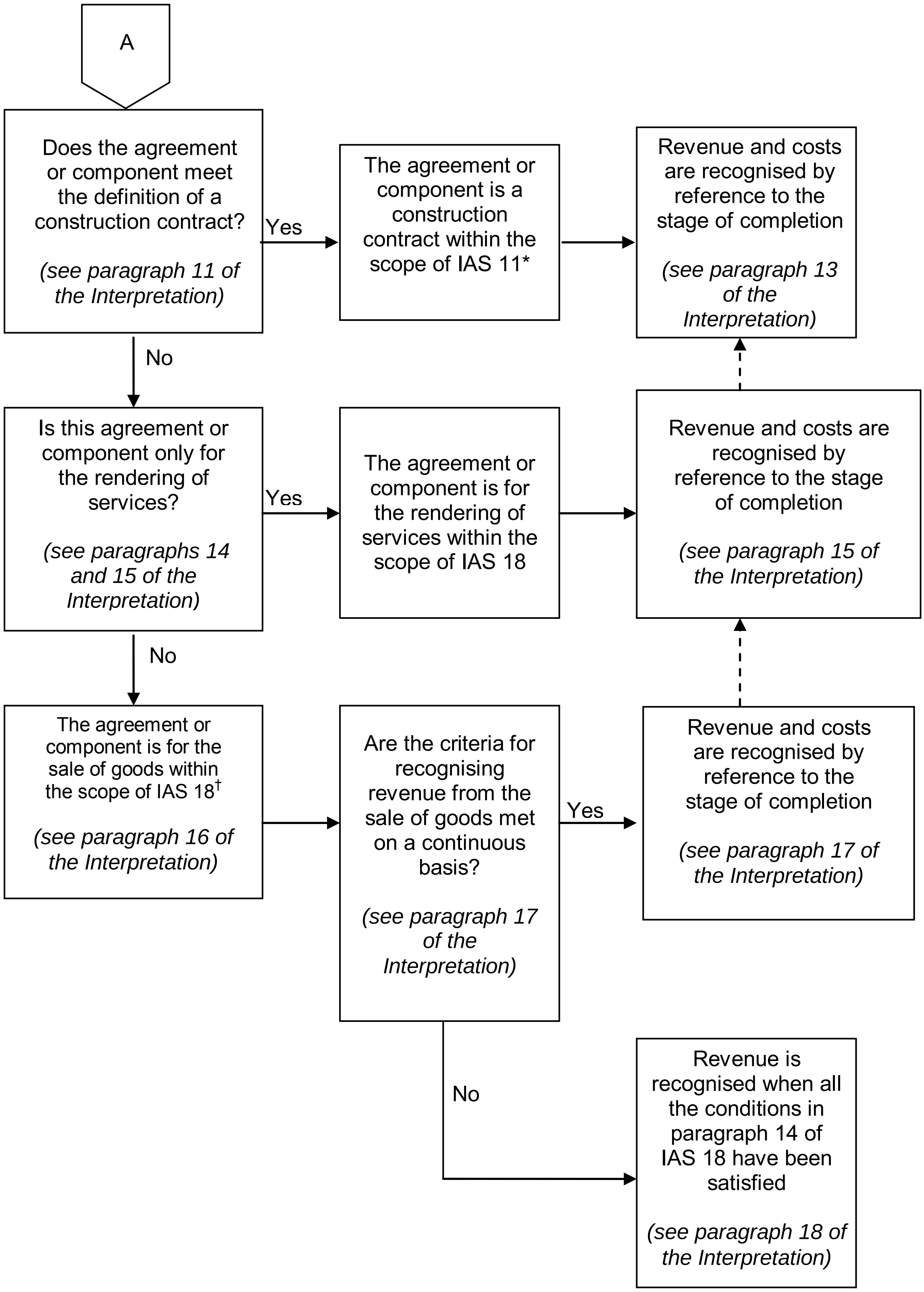

* The construction contract may need to be segmented in accordance with paragraph 8 of IAS 11
† Directly related services may need to be separated in accordance with paragraph 13 of IAS 18

Illustrative examples

These examples accompany, but are not part of, IFRIC 15.

Example 1

IE1 An entity buys a plot of land for the construction of commercial real estate. It designs an office block to build on the land and submits the designs to planning authorities in order to obtain building permission. The entity markets the office block to potential tenants and signs conditional lease agreements. The entity markets the office block to potential buyers and signs with one of them a conditional agreement for the sale of land and the construction of the office block. The buyer cannot put the land or the incomplete office block back to the entity. The entity receives the building permission and all agreements become unconditional. The entity is given access to the land in order to undertake the construction and then constructs the office block.

IE2 In this illustrative example, the agreement should be separated into two components: a component for the sale of land and a component for the construction of the office block. The component for the sale of land is a sale of goods within the scope of IAS 18.

IE3 Because all the major structural decisions were made by the entity and were included in the designs submitted to the planning authorities before the buyer signed the conditional agreement, it is assumed that there will be no major change in the designs after the construction has begun. Consequently, the component for the construction of the office block is not a construction contract and is within the scope of IAS 18. The facts, including that the construction takes place on land the buyer owns before construction begins and that the buyer cannot put the incomplete office block back to the entity, indicate that the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Therefore, if all the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity recognises revenue from the construction of the office block by reference to the stage of completion using the percentage of completion method.

IE4 Alternatively, assume that the construction of the office block started before the entity signed the agreement with the buyer. In that event, the agreement should be separated into three components: a component for the sale of land, a component for the partially constructed office block and a component for the construction of the office block. The entity should apply the recognition criteria separately to each component. Assuming that the other facts remain unchanged, the entity recognises revenue from the component for the construction of the office block by reference to the stage of completion using the percentage of completion method as explained in paragraph IE3.

IE5 In this example, the sale of land is determined to be a separately identifiable component from the component for the construction of real estate. However, depending on facts and circumstances, the entity may conclude that such a component is not separately identifiable. For example, in some jurisdictions, a condominium is legally defined as the absolute ownership of a unit based on a legal description of the airspace the unit actually occupies, plus an undivided interest in the ownership of the common elements (that includes the land and actual building itself, all the driveways, parking, lifts, outside hallways, recreation and landscaped areas) that are owned jointly with the other condominium unit owners. In this case, the undivided interest in the ownership of the common elements does not give the buyer control and the significant risks and rewards of the land itself. Indeed, the right to the unit itself and the interest in the common elements are not separable.

Example 2

IE6 An entity is developing residential real estate and starts marketing individual units (apartments) while construction is still in progress. Buyers enter into a binding sale agreement that gives them the right to acquire a specified unit when it is ready for occupation. They pay a deposit that is refundable only if the entity fails to deliver the completed unit in accordance with the contracted terms. Buyers are also required to make progress payments between the time of the initial agreement and contractual completion. The balance of the purchase price is paid only on contractual completion, when buyers obtain possession of their unit. Buyers are able to specify only minor variations to the basic design but they cannot specify or alter major structural elements of the design of their unit. In the jurisdiction, no rights to the underlying real estate asset transfer to the buyer other than through the agreement. Consequently, the construction takes place regardless of whether sale agreements exist.

IE7 In this illustrative example, the terms of the agreement and all the surrounding facts and circumstances indicate that the agreement is not a construction contract. The agreement is a forward contract that gives the buyer an asset in the form of a right to acquire, use and sell the completed real estate at a later date and an obligation to pay the purchase price in accordance with its terms. Although the buyer might be able to transfer its interest in the forward contract to another party, the entity retains control and the significant risks and rewards of ownership of the work in progress in its current state until the completed real estate is transferred. Therefore, revenue should be recognised only when all the criteria in paragraph 14 of IAS 18 are met (at completion in this example).

IE8 Alternatively, assume that, in the jurisdiction, the law requires the entity to transfer immediately to the buyer ownership of the real estate in its current state of completion and that any additional construction becomes the property of the buyer as construction progresses. The entity would need to consider all the terms of the agreement to determine whether this change in the timing of the transfer of ownership means that the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. For example, the fact that if the agreement is terminated before construction is complete, the buyer retains the work in progress and the entity has the right to be paid for the work performed, might indicate that control is transferred along with ownership. If it does, and if all the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity recognises revenue by reference to the stage of completion using the percentage of completion method taking into account the stage of completion of the whole building and the agreements signed with individual buyers.

Example 3

IE9 Determining whether the entity will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed real estate to an extent that would preclude recognition of some or all of the consideration as revenue depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement. The Interpretation assumes the entity has reached the conclusion that it is appropriate to recognise revenue from the agreement and discusses how to determine the appropriate pattern of revenue recognition.

IE10 Agreements for the construction of real estate may include such a degree of continuing managerial involvement by the entity undertaking the construction that control and the significant risks and rewards of ownership are not transferred even when construction is complete and the buyer obtains possession. Examples are agreements in which the entity guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such circumstances, recognition of revenue may be delayed or precluded altogether.

IE11 Agreements for the construction of real estate may give the buyer a right to take over the work in progress (albeit with a penalty) during construction, eg to engage a different entity to complete the construction. This fact, along with others, may indicate that the entity transfers to the buyer control of the work in progress in its current state as construction progresses. The entity that undertakes the construction of real estate will have access to the land and the work in progress in order to perform its contractual obligation to deliver to the buyer completed real estate. If control of the work in process is transferred continuously, that access does not necessarily imply that the entity undertaking the construction retains continuing managerial involvement with the real estate to the degree usually associated with ownership to an extent that would preclude recognition of some or all of the consideration as revenue. The entity may have control over the activities related to the performance of its contractual obligation but not over the real estate itself.

Basis for Conclusions on IFRIC 15 *Agreements for the Construction of Real Estate*

This Basis for Conclusions accompanies, but is not part of, IFRIC 15.

HK(IFRIC)-Int 15 is based on IFRIC Interpretation 15 *Agreements for the Construction of Real Estate*. In approving HK(IFRIC)-Int 15, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 15. Accordingly, there are no significant differences between HK(IFRIC)-Int 15 and IFRIC Interpretation 15. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 15 referred to below generally correspond with those in HK(IFRIC)-Int 15.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC released draft Interpretation D21 *Real Estate Sales* for public comment in July 2007 and received 51 comment letters in response.

Scope

BC3 Agreements for the construction of real estate are widespread and may relate to residential, commercial or industrial developments. Construction often spans more than one accounting period, may take place on land the buyer owns or leases before construction begins and agreements may require progress payments.

BC4 The main area of divergence in practice concerns the identification of the applicable accounting standard for agreements for the construction of real estate. In some jurisdictions, the prevailing practice is to apply IAS 11 *Construction Contracts* and to recognise revenue as construction progresses. In others, it is to apply the requirements for the sale of goods in IAS 18 *Revenue* and to recognise revenue only when the completed real estate is delivered to the buyer.

BC5 The IFRIC considered whether the scope of the Interpretation should be confined to agreements for the construction of real estate. It concluded in D21 that the scope should be limited to the request received to clarify the requirements of IAS 18 with respect to 'real estate sales' because that was the area identified as having the most diversity in practice. In redeliberating the issue, the IFRIC took the view that the notion of 'real estate sales' in D21 might create confusion and clarified that this Interpretation applies to 'agreements for the construction of real estate'. The primary issue of whether an agreement is within the scope of IAS 11 or IAS 18 arises only when agreements include construction activities. Such agreements may or may not meet the definition of a construction contract. The IFRIC also clarified that the Interpretation might affect entities that undertake the construction of real estate, directly or through subcontractors.

BC6 The IFRIC noted that respondents to D21 were concerned about the implications of the IFRIC's conclusions for agreements that required manufacture of goods to a customer's specifications in industries other than real estate. The IFRIC reconsidered the scope of the Interpretation after it had redeliberated its conclusions with respect to agreements for the construction of real estate. It concluded that the scope of the Interpretation should remain confined to agreements for the construction of real estate. The IFRIC noted that it might be applied by analogy to industries other than real estate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Issue

BC7 The issue is when should revenue from the construction of real estate be recognised? In International Financial Reporting Standards (IFRSs), two standards deal with accounting for revenue: IAS 18 and IAS 11. Because many agreements involve the construction or manufacture of an asset to meet customer's specifications, the IFRIC was asked to clarify how to determine whether an agreement for the construction of real estate is a construction contract within the scope of IAS 11.

Consensus

BC8 The nature and extent of the entity's continuing managerial involvement with the item sold may affect the accounting for the transaction. It may be accounted for as a sale, or as a financing, leasing or some other profit-sharing arrangement. Because the issue addressed in this Interpretation is a revenue recognition issue, the Interpretation assumes that the entity has previously analysed the agreement for the construction of real estate and any related agreements and concluded that it will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed real estate to an extent that would preclude recognition of some or all of the consideration as revenue. This assumption, that the entity would recognise revenue at some point and the issue was one of timing, was implicit in D21 but was not clearly stated. In response to comments received, the IFRIC clarified that an entity must have concluded that the arrangement will result in the recognition of revenue to be within the scope of the Interpretation.

BC9 Some respondents to D21 asked the IFRIC to provide guidance on agreements with multiple components so the Interpretation would cover the more complex transactions that often occur in practice.

BC10 In its redeliberations, the IFRIC noted that, in addition to the construction of real estate, an agreement may include the delivery of other goods or services (eg a sale of land or provision of property management services). In accordance with paragraph 13 of IAS 18, such an agreement may need to be split into separately identifiable components, including one for the construction of real estate. Because IAS 18 is the standard that sets out requirements for revenue recognition in general, the IFRIC decided to consider the issue in the context of IAS 18, ie an entity should first determine whether an agreement that includes the construction of real estate also includes other components that do not need further analysis in this Interpretation.

BC11 The IFRIC noted that IFRIC 12 *Service Concession Arrangements* and IFRIC 13 *Customer Loyalty Programmes* already provide guidance on determining whether a single agreement should be divided into components and, if so, how to allocate the fair value of the total consideration received or receivable for the agreement to each component (see paragraph 13 of IFRIC 12 and paragraphs 5–7 of IFRIC 13). Therefore, the IFRIC concluded that this Interpretation should include only a reminder in paragraph 8 that such identification and allocation are required.

BC12 Regarding the issue of whether and when there is a separately identifiable component for the sale of land, the IFRIC concluded from the existing guidance that the identification of a component for the sale of land should be undertaken when first analysing any potential components. Depending on facts and circumstances, the entity may or may not conclude that such a component is separately identifiable from the component for the construction of real estate.

BC13 The IFRIC noted that respondents were uncertain whether an entity applying D21 would follow the guidance on combining and segmenting contracts in IAS 18 or that in IAS 11. The approach adopted in the Interpretation makes it clear that the specific criteria for contract segmentation in IAS 11 are applied only after the entity has concluded that the agreement is within the scope of that standard.

Determining whether the agreement is within the scope of IAS 11 or IAS 18

BC14 One view is that IAS 11 applies to all agreements for the construction of real estate. In support of this view, it is argued that:

(a) these agreements are in substance construction contracts. The typical features of a construction contract—land development, structural engineering, architectural design and construction—are all present.

(b) IAS 11 requires a percentage of completion method of revenue recognition for construction contracts. Revenue is recognised progressively as work is performed. Because many real estate development projects span more than one accounting period, the rationale for this method—that it 'provides useful information on the extent of contract activity and performance during a period' (IAS 11 paragraph 25)—applies to real estate development as much as it does to other construction contracts. If revenue is recognised only when the IAS 18 conditions for recognising revenue from the sale of goods are met, the financial statements do not reflect the entity's economic value generation in the period and are susceptible to manipulation.

(c) US Statement of Financial Accounting Standards No. 66 *Accounting for Sales of Real Estate* requires a percentage of completion method for recognising profit from sales of units in condominium projects or time-sharing interests (provided specified criteria are met). Thus US generally accepted accounting principles (GAAP) acknowledge that such real estate sales have the same economic substance as construction-type contracts. IFRSs can and should be interpreted in the same way to avoid unnecessary differences.

BC15 A second view is that IAS 11 applies only when the agreement meets the definition of a construction contract. When the agreement does not meet the definition of a construction contract, the agreement is within the scope of IAS 18.

BC16 The consensus reflects the second view. In reaching this consensus, the IFRIC noted that:

(a) the facts that the construction spans more than one accounting period and requires progress payments are not relevant features to consider when determining the applicable standard and the timing of revenue recognition.

(b) determining whether an agreement for the construction of real estate is within the scope of IAS 11 or IAS 18 depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement with respect to each agreement. It is not an accounting policy choice.

(c) IAS 11 lacks specific guidance on the definition of a construction contract and further application guidance is needed to help identify construction contracts.

(d) differences exist between the requirements in IFRSs and US GAAP for revenue recognition in general and for construction contracts in particular. They cannot be eliminated by interpretation. They are being addressed in a general project on revenue recognition conducted jointly by the IASB and the US Financial Accounting Standards Board.

BC17 The IFRIC noted that when IAS 11 applies, for accounting purposes, the construction contract also includes contracts for the rendering of services that are directly related to the construction of the real estate in accordance with paragraph 4 of IAS 18 and paragraph 5(a) of IAS 11.

BC18 In D21 the IFRIC concluded that an agreement for the construction of real estate would be within the scope of IAS 11 in two circumstances—if the agreement met the definition of a construction contract and/or if control and the significant risks and rewards of ownership of the work in progress in its current state transferred to the buyer continuously as construction progresses. Many respondents pointed out that IAS 11 does not require 'continuous transfer' for the use of the percentage of completion method, only that the contract be a 'construction contract'. The IFRIC clarified in the consensus that IAS 11 applies only when the agreement meets the definition of a construction contract and carried forward into the Interpretation the guidance in paragraphs 9(a), 10(a) and BC5(a) of D21.

BC19 In addition, many respondents asked the IFRIC to provide guidance to distinguish between construction contracts that meet the definition included in D21 and other agreements for the manufacture of goods to a customer's specifications. The IFRIC concluded that the most important distinguishing feature is whether the customer is actually specifying the main elements of the structural design. In situations involving the manufacture of goods to a customer's specifications, the customer generally does not have the ability to specify or alter the basic design of the product. Rather, the customer is simply choosing elements from a range of options specified by the seller or specifying only minor variations to the basic design. The IFRIC decided to include guidance to this effect in the Interpretation to help clarify the application of the definition of a construction contract.

Accounting for revenue from the construction of real estate

BC20 When the agreement is within the scope of IAS 11 and its outcome can be estimated reliably, the entity should recognise revenue by reference to the stage of completion in accordance with IAS 11.

BC21 When the agreement does not meet the definition of a construction contract, the agreement is within the scope of IAS 18. The IFRIC identified the following types of agreements for the construction of real estate that are within the scope of IAS 18 and that are distinguishable in substance:

(a) agreements for the rendering of services only;

(b) two types of agreements for the sale of goods:

  (i) agreements in which the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses;

  (ii) agreements in which the entity transfers to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (eg at completion, upon or after delivery).

BC22 The IFRIC noted that a customer may decide to act in essence as its own general contractor and enter into agreements with individual suppliers for specific goods and services. When the entity is responsible only for assembling materials supplied by others (ie it has no inventory risk for the construction materials), the agreement is an agreement for the rendering of services. The IFRIC noted that, if the criteria in paragraph 20 are met, IAS 18 requires revenue to be recognised by reference to the stage of completion using the percentage of completion method. IAS 18 then refers to IAS 11 and states that the requirements of IAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction.

BC23 The IFRIC also noted that construction activities often require an entity that undertakes the construction of real estate, directly or through subcontractors, to provide services together with construction materials. However, the entity delivers to the buyer a real estate asset, either completed or in its current stage of completion. Therefore, the IFRIC concluded that the criteria in paragraph 14 of IAS 18 for recognition of revenue from the sale of goods should apply to such agreements.

BC24 As noted in paragraph BC18, the IFRIC agreed with respondents to D21 that IAS 11 does not require the entity to transfer to the buyer control and the significant risks and rewards of ownership of the work in process in its current state as construction progresses ('continuous transfer') in order to use the percentage of completion method, only that the contract be a 'construction contract'. In its redeliberations, the IFRIC noted that the criterion it included in paragraph 9(b) of D21 was actually one of the criteria in IAS 18 for recognition of revenue from the sale of goods. Although these agreements may not meet the definition of construction contracts, the IFRIC concluded that they may result in the entity meeting all of the criteria for recognising revenue from the sale of goods in IAS 18 (including the transfer of control and the significant risks and rewards of ownership) continuously as construction progresses, as opposed to at a single time (eg at completion, upon or after delivery).

BC25 The IFRIC concluded that if all these criteria are met continuously, an entity should recognise revenue on the same basis (by reference to the stage of completion). Like paragraph 21 of IAS 18 for the rendering of services, the Interpretation refers entities to IAS 11 for guidance on applying the percentage of completion method. The IFRIC observed that this conclusion was consistent with the basis for using the percentage of completion method in Statement of Position No. 81–1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* issued by the American Institute of Certified Public Accountants, which states:

> …the business activity taking place supports the concept that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses...

BC26 The IFRIC noted that agreements with 'continuous transfer' might not be encountered frequently. However, the IFRIC decided that the Interpretation should address the accounting for such agreements because some respondents to D21 identified agreements with these characteristics.

BC27 The IFRIC also identified agreements for the construction of real estate in which the entity transfers to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (eg at completion, upon or after delivery). The IFRIC reaffirmed its conclusion in D21 that these agreements are sales of goods within the scope of IAS 18. Such agreements give the buyer only an asset in the form of a right to acquire, use and sell the completed real estate at a later date. The IFRIC concluded that revenue from such agreements should be recognised only when all the criteria in paragraph 14 of IAS 18 are satisfied.

BC28 The IFRIC noted that this conclusion is consistent with revenue recognition requirements for significant contracts for the delivery of multiple units of goods manufactured to the customer's specifications over more than one accounting period, such as subway cars. In such circumstances, the entity recognises revenue as individual units (or groups of units) are delivered. However, in contrast to the contracts described in paragraph BC24, control and the significant risks and rewards of ownership of the work in process in its current state do not transfer to the buyer as construction/manufacture progresses. This transfer takes place only on delivery of the completed units. In this case, the entity would apply the requirements of paragraph 14 of IAS 18 at that time; use of the percentage of completion method would not be appropriate.

BC29 In some circumstances, an entity has to perform further work on real estate already delivered to the buyer. The IFRIC noted that IFRIC 13 *Customer Loyalty Programmes* already provides guidance on how to apply paragraphs 13 and 19 of IAS 18. Paragraph BC9 of IFRIC 13 states that:

> … IAS 18 does not give explicit guidance. However, the aim of IAS 18 is to recognise revenue when, and to the extent that, goods or services have been delivered to a customer. In the IFRIC's view, paragraph 13 applies if a single transaction requires two or more separate goods or services to be delivered at different times; it ensures that revenue for each item is recognised only when that item is delivered. In contrast, paragraph 19 applies only if the entity has to incur further costs directly related to items already delivered, eg to meet warranty claims. In the IFRIC's view, loyalty awards are not costs that directly relate to the goods and services already delivered—rather, they are separate goods or services delivered at a later date …

BC30 The IFRIC concluded that the Interpretation should provide similar guidance.

Disclosures

BC31 The IFRIC noted that IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to provide disclosures about its significant accounting policies (paragraph 117), judgements management has made in applying those policies (paragraph 122) and major sources of estimation uncertainty.

BC32 For greater certainty, the IFRIC concluded that, for agreements with 'continuous transfer', the Interpretation should require specific disclosures similar to those of paragraphs 39 and 40 of IAS 11 to satisfy the general requirements of IAS 1.

BC33 The IFRIC noted that this conclusion was generally consistent with D21 because D21 included such agreements in the scope of IAS 11 and therefore implicitly required the full disclosures of that standard.

Changes from draft Interpretation D21

BC34 Most respondents to D21 supported the IFRIC's conclusion that it should develop an interpretation on this issue. However, nearly all respondents expressed concern with some aspects of the proposals or the possible application by analogy to industries other than real estate.

BC35 The most significant changes made from D21 in the light of comments received relate to:

(a) *scope.* D21 referred to 'real estate sales'. The IFRIC clarified that the Interpretation applies to agreements for the construction of real estate.

(b) *applicable standard.* D21 listed typical features, including 'continuous transfer', to help determine whether an agreement for the construction of real estate is within the scope of IAS 11 or IAS 18. The IFRIC concluded that only agreements that meet the definition of a construction contract are within the scope of IAS 11 and carried forward into the Interpretation the guidance in paragraphs 9(a), 10(a) and BC5(a) of D21 on when a contract satisfies that definition.

(c) *continuous transfer.* Many respondents believed that the indicator of 'continuous transfer' (the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses) set out in paragraph 9(b) of D21 was relevant, although not specifically included in IAS 11. The IFRIC took the view that when the criteria for recognising revenue from the sale of goods set out in paragraph 14 of IAS 18 are met continuously, it is appropriate to recognise revenue as the criteria are met. The IFRIC carried forward the criterion set out in paragraph 9(b) of D21 and concluded that the percentage of completion method appropriately recognises revenue in such circumstances. However, the IFRIC did not carry forward the features set out in paragraph 9(b)(i)–(iii) of D21 on the basis that the criterion was sufficiently clear. Overall, the Interpretation and D21 provide similar revenue recognition conclusions for agreements with 'continuous transfer' but for different reasons.

(d) *multiple components.* Some respondents to D21 asked the IFRIC to address the issue of a single agreement with multiple components in order to cover the more complex transactions that often occur in practice. The requirements of IAS 18 in this respect have been included in the consensus and the issue is also addressed in an illustrative example.

(e) *disclosures.* D21 did not specify disclosures because agreements with 'continuous transfer' were included in the scope of IAS 11 and its disclosure requirements would have automatically applied. Paragraphs 20 and 21 of the Interpretation have been added to require specific disclosures for such agreements that now fall within the scope of IAS 18.

(f) *flow chart and illustrative examples.* The IFRIC decided that a flow chart and illustrative examples should accompany, but not be part of, the Interpretation to help entities apply the Interpretation.

HK(IFRIC)-Int 16
Revised ~~May 2009~~August 2010

Effective for annual periods
beginning on or after 1 October 2008

HK(IFRIC) Interpretation 16

Hedges of a Net Investment in a Foreign Operation

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

CONTENTS

Hong Kong (IFRIC) Interpretation 16 *Hedges of a Net Investment in a Foreign Operation* (HK(IFRIC)-Int 16) is set out in paragraphs 1–19 and the Appendix. HK(IFRIC)-Int 16 is accompanied by an illustrative example and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 16
Hedges of a Net Investment in a Foreign Operation

References

- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 21 *The Effects of Changes in Foreign Exchange Rates*
- HKAS 39 *Financial Instruments: Recognition and Measurement*

Background

1 Many reporting entities have investments in foreign operations (as defined in HKAS 21 paragraph 8). Such foreign operations may be subsidiaries, associates, joint ventures or branches. HKAS 21 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognise foreign exchange differences in other comprehensive income until it disposes of the foreign operation.

2 Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements.* The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.

3 HKAS 39 requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognised in other comprehensive income and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.

4 An entity with many foreign operations may be exposed to a number of foreign currency risks. This Interpretation provides guidance on identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation.

5 HKAS 39 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This Interpretation provides guidance on where, within a group, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting.

6 HKAS 21 and HKAS 39 require cumulative amounts recognised in other comprehensive income relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be reclassified from equity to profit or loss as a reclassification adjustment when the parent disposes of the foreign operation. This Interpretation provides guidance on how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item.

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* This will be the case for consolidated financial statements, financial statements in which investments 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.

Scope

7 This Interpretation applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with HKAS 39. For convenience this Interpretation refers to such an entity as a parent entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a parent entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.

8 This Interpretation applies only to hedges of net investments in foreign operations; it should not be applied by analogy to other types of hedge accounting.

Issues

9 Investments in foreign operations may be held directly by a parent entity or indirectly by its subsidiary or subsidiaries. The issues addressed in this Interpretation are:

(a) *the nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated:*

(i) whether the parent entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the parent entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the parent entity's consolidated financial statements and the functional currency of the foreign operation;

(ii) if the parent entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate parent entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate parent entity (ie whether the fact that the net investment in the foreign operation is held through an intermediate parent affects the economic risk to the ultimate parent).

(b) *where in a group the hedging instrument can be held:*

(i) whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity in the group, regardless of its functional currency, can hold the hedging instrument;

(ii) whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.

(c) *what amounts should be reclassified from equity to profit or loss as reclassification adjustments on disposal of the foreign operation:*

(i) when a foreign operation that was hedged is disposed of, what amounts from the parent entity's foreign currency translation reserve in respect of the hedging instrument and in respect of that foreign operation should be reclassified from equity to profit or loss in the parent entity's consolidated financial statements;

(ii) whether the method of consolidation affects the determination of the amounts to be reclassified from equity to profit or loss.

Conclusions

Nature of the hedged risk and amount of the hedged item for which a hedging relationship may be designated

10 Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the parent entity's functional currency.

11 In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the parent entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a parent depends on whether any lower level parent of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the parent's consolidated financial statements.

12 The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any parent entity (the immediate, intermediate or ultimate parent entity) of that foreign operation. The fact that the net investment is held through an intermediate parent does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate parent entity.

13 An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one parent entity within the group (for example, both a direct and an indirect parent entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate parent. A hedging relationship designated by one parent entity in its consolidated financial statements need not be maintained by another higher level parent entity. However, if it is not maintained by the higher level parent entity, the hedge accounting applied by the lower level parent must be reversed before the higher level parent's hedge accounting is recognised.

Where the hedging instrument can be held

14 A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the group~~ (except the foreign operation that itself is being hedged)~~, as long as the designation, documentation and effectiveness requirements of HKAS 39 paragraph 88 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the group should be clearly documented because of the possibility of different designations at different levels of the group.

15 For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the parent entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognised in profit or loss, in other comprehensive income, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognised in profit or loss or in other comprehensive income. As part of the application of hedge accounting, the total effective portion of the change is included in other comprehensive income. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

Disposal of a hedged foreign operation

16 When a foreign operation that was hedged is disposed of, the amount reclassified to profit or loss as a reclassification adjustment from the foreign currency translation reserve in the consolidated financial statements of the parent in respect of the hedging instrument is the amount that HKAS 39 paragraph 102 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.

17 The amount reclassified to profit or loss from the foreign currency translation reserve in the consolidated financial statements of a parent in respect of the net investment in that foreign operation in accordance with HKAS 21 paragraph 48 is the amount included in that parent's foreign currency translation reserve in respect of that foreign operation. In the ultimate parent's consolidated financial statements, the aggregate net amount recognised in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate parent uses the direct or the step-by-step method of consolidation[*] may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation. The use of the step-by-step method of consolidation may result in the reclassification to profit or loss of an amount different from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by HKAS 21. However, it is an accounting policy choice that should be followed consistently for all net investments.

Effective date

18 An entity shall apply this Interpretation for annual periods beginning on or after 1 October 2008. An entity shall apply the amendment to paragraph 14 made by *Improvements to HKFRSs* issued in May 2009 for annual periods beginning on or after 1 July 2009. Earlier application of both is permitted. If an entity applies this Interpretation for a period beginning before 1 October 2008, or the amendment to paragraph 14 before 1 July 2009, it shall disclose that fact.

Transition

19 HKAS 8 specifies how an entity applies a change in accounting policy resulting from the initial application of an Interpretation. An entity is not required to comply with those requirements when first applying the Interpretation. If an entity had designated a hedging instrument as a hedge of a net investment but the hedge does not meet the conditions for hedge accounting in this Interpretation, the entity shall apply HKAS 39 to discontinue that hedge accounting prospectively.

[*] The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate parent. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate parent(s) and then translated into the functional currency of the ultimate parent (or the presentation currency if different).

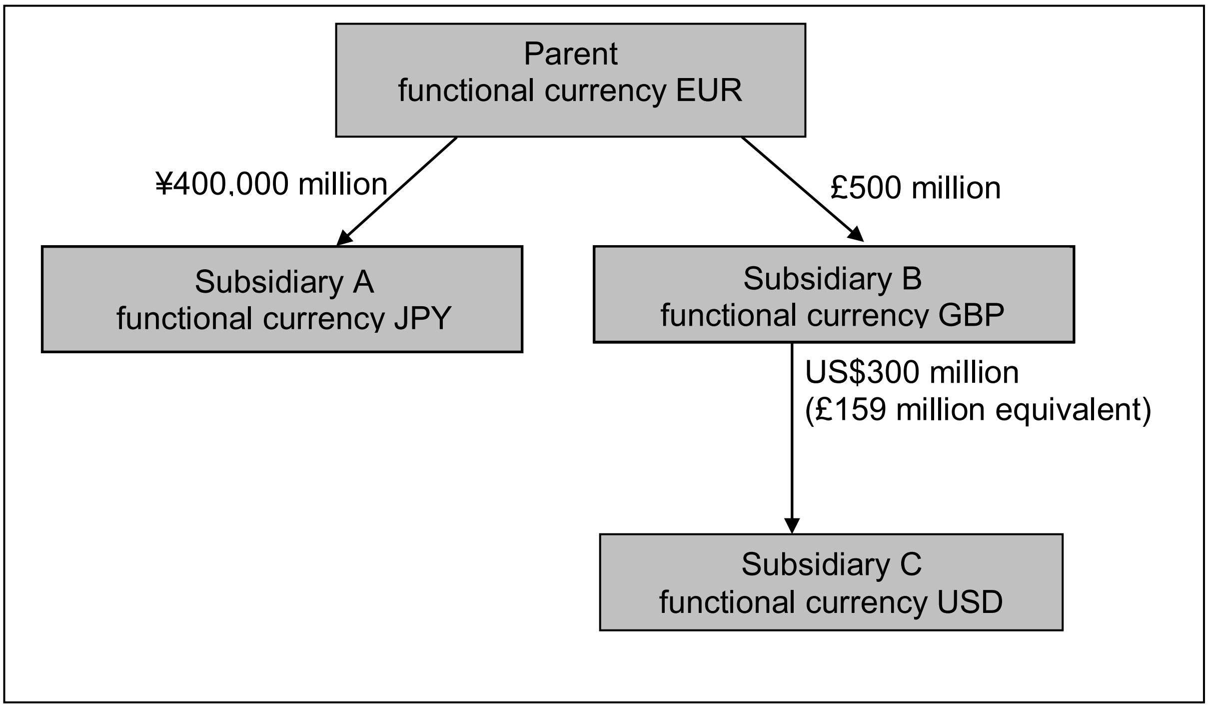
Appendix
Application guidance

This appendix is an integral part of the Interpretation.

AG1 This appendix illustrates the application of the Interpretation using the corporate structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with HKAS 39, although this testing is not discussed in this appendix. Parent, being the ultimate parent entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the subsidiaries is wholly owned. Parent's £500 million net investment in Subsidiary B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Subsidiary B's US$300 million net investment in Subsidiary C (functional currency US dollars (USD)). In other words, Subsidiary B's net assets other than its investment in Subsidiary C are £341 million.

Nature of hedged risk for which a hedging relationship may be designated (paragraphs 10–13)

AG2 Parent can hedge its net investment in each of Subsidiaries A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Parent can hedge the USD/GBP foreign exchange risk between the functional currencies of Subsidiary B and Subsidiary C. In its consolidated financial statements, Subsidiary B can hedge its net investment in Subsidiary C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Parent could designate the forward foreign exchange risk.



Amount of hedged item for which a hedging relationship may be designated (paragraphs 10–13)

AG3 Parent wishes to hedge the foreign exchange risk from its net investment in Subsidiary C. Assume that Subsidiary A has an external borrowing of US$300 million. The net assets of Subsidiary A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US$300 million.

AG4 The hedged item can be an amount of net assets equal to or less than the carrying amount of Parent's net investment in Subsidiary C (US$300 million) in its consolidated financial statements. In its consolidated financial statements Parent can designate the US$300 million external borrowing in Subsidiary A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US$300 million net assets of Subsidiary C. In this case, both the EUR/USD foreign exchange difference on the US$300 million external borrowing in Subsidiary A and the EUR/USD foreign exchange difference on the US$300 million net investment in Subsidiary C are included in the foreign currency translation reserve in Parent's consolidated financial statements after the application of hedge accounting.

AG5 In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Subsidiary A would be recognised in Parent's consolidated financial statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in profit or loss, and
- JPY/EUR spot foreign exchange rate change in other comprehensive income.

Instead of the designation in paragraph AG4, in its consolidated financial statements Parent can designate the US$300 million external borrowing in Subsidiary A as a hedge of the GBP/USD spot foreign exchange risk between Subsidiary C and Subsidiary B. In this case, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Subsidiary A would instead be recognised in Parent's consolidated financial statements as follows:

- the GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Subsidiary C,
- GBP/JPY spot foreign exchange rate change, translated to euro, in profit or loss, and
- JPY/EUR spot foreign exchange rate change in other comprehensive income.

AG6 Parent cannot designate the US$300 million external borrowing in Subsidiary A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Subsidiary B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the group comprising Subsidiary B and Subsidiary C.

Where in a group can the hedging instrument be held (paragraphs 14 and 15)?

AG7 As noted in paragraph AG5, the total change in value in respect of foreign exchange risk of the US$300 million external borrowing in Subsidiary A would be recorded in both profit or loss (USD/JPY spot risk) and other comprehensive income (EUR/JPY spot risk) in Parent's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph AG4 because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Parent against the US dollar functional currency of Subsidiary C, in accordance with the hedge documentation. The method of consolidation (ie direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts reclassified to profit or loss on disposal of a foreign operation (paragraphs 16 and 17)

AG8 When Subsidiary C is disposed of, the amounts reclassified to profit or loss in Parent's consolidated financial statements from its foreign currency translation reserve (FCTR) are:

(a) in respect of the US$300 million external borrowing of Subsidiary A, the amount that HKAS 39 requires to be identified, ie the total change in value in respect of foreign exchange risk that was recognised in other comprehensive income as the effective portion of the hedge; and

(b) in respect of the US$300 million net investment in Subsidiary C, the amount determined by the entity's consolidation method. If Parent uses the direct method, its FCTR in respect of Subsidiary C will be determined directly by the EUR/USD foreign exchange rate. If Parent uses the step-by-step method, its FCTR in respect of Subsidiary C will be determined by the FCTR recognised by Subsidiary B reflecting the GBP/USD foreign exchange rate, translated to Parent's functional currency using the EUR/GBP foreign exchange rate. Parent's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be reclassified when it disposes of Subsidiary C to be the amount that it would have recognised if it had always used the direct method, depending on its accounting policy.

Hedging more than one foreign operation (paragraphs 11, 13 and 15)

AG9 The following examples illustrate that in the consolidated financial statements of Parent, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Subsidiaries B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Parent's consolidated financial statements when both foreign operations are hedged are US$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Parent's consolidated profit or loss. Of course, it would be possible for Parent to designate US$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

Parent holds both USD and GBP hedging instruments

AG10 Parent may wish to hedge the foreign exchange risk in relation to its net investment in Subsidiary B as well as that in relation to Subsidiary C. Assume that Parent holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Subsidiary B and Subsidiary C. The designations Parent can make in its consolidated financial statements include, but are not limited to, the following:

(a) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in Subsidiary C with the risk being the spot foreign exchange exposure (EUR/USD) between Parent and Subsidiary C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Subsidiary B with the risk being the spot foreign exchange exposure (EUR/GBP) between Parent and Subsidiary B.

(b) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in Subsidiary C with the risk being the spot foreign exchange exposure (GBP/USD) between Subsidiary B and Subsidiary C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Subsidiary B with the risk being the spot foreign exchange exposure (EUR/GBP) between Parent and Subsidiary B.

AG11 The EUR/USD risk from Parent's net investment in Subsidiary C is a different risk from the EUR/GBP risk from Parent's net investment in Subsidiary B. However, in the case described in paragraph AG10(a), by its designation of the USD hedging instrument it holds, Parent has already fully hedged the EUR/USD risk from its net investment in Subsidiary C. If Parent also designated a GBP instrument it holds as a hedge of its £500 million net investment in Subsidiary B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Subsidiary C, would be hedged twice for GBP/EUR risk in Parent's consolidated financial statements.

AG12 In the case described in paragraph AG10(b), if Parent designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Subsidiary B and Subsidiary C, only the GBP/USD part of the change in the value of its US$300 million hedging instrument is included in Parent's foreign currency translation reserve relating to Subsidiary C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Parent's consolidated profit or loss, as in paragraph AG5. Because the designation of the USD/GBP risk between Subsidiaries B and C does not include the GBP/EUR risk, Parent is also able to designate up to £500 million of its net investment in Subsidiary B with the risk being the spot foreign exchange exposure (GBP/EUR) between Parent and Subsidiary B.

Subsidiary B holds the USD hedging instrument

AG13 Assume that Subsidiary B holds US$300 million of external debt, the proceeds of which were transferred to Parent by an inter-company loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Subsidiary B's net assets are unchanged. Subsidiary B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Subsidiary C in its consolidated financial statements. Parent could maintain Subsidiary B's designation of that hedging instrument as a hedge of its US$300 million net investment in Subsidiary C for the GBP/USD risk (see paragraph 13) and Parent could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Subsidiary B. The first hedge, designated by Subsidiary B, would be assessed by reference to Subsidiary B's functional currency (pounds sterling) and the second hedge, designated by Parent, would be assessed by reference to Parent's functional currency (euro). In this case, only the GBP/USD risk from Parent's net investment in Subsidiary C has been hedged in Parent's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Parent's £500 million net investment in Subsidiary B may be hedged in the consolidated financial statements of Parent.

AG14 However, the accounting for Parent's £159 million loan payable to Subsidiary B must also be considered. If Parent's loan payable is not considered part of its net investment in Subsidiary B because it does not satisfy the conditions in HKAS 21 paragraph 15, the GBP/EUR foreign exchange difference arising on translating it would be included in Parent's consolidated profit or loss. If the £159 million loan payable to Subsidiary B is considered part of Parent's net investment, that net investment would be only £341 million and the amount Parent could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.

AG15 If Parent reversed the hedging relationship designated by Subsidiary B, Parent could designate the US$300 million external borrowing held by Subsidiary B as a hedge of its US$300 million net investment in Subsidiary C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Subsidiary B. In this case the effectiveness of both hedges would be computed by reference to Parent's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Subsidiary B and the GBP/EUR change in value of Parent's loan payable to Subsidiary B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Parent's consolidated financial statements. Because Parent has already fully hedged the EUR/USD risk from its net investment in Subsidiary C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Subsidiary B.

Illustrative example

This example accompanies, but is not part of, IFRIC 16.

Disposal of a foreign operation (paragraphs 16 and 17)

IE1 This example illustrates the application of paragraphs 16 and 17 in connection with the reclassification adjustment on the disposal of a foreign operation.

Background

IE2 This example assumes the group structure set out in the application guidance and that Parent used a USD borrowing in Subsidiary A to hedge the EUR/USD risk of the net investment in Subsidiary C in Parent's consolidated financial statements. Parent uses the step-by-step method of consolidation. Assume the hedge was fully effective and the full USD/EUR accumulated change in the value of the hedging instrument before disposal of Subsidiary C is €24 million (gain). This is matched exactly by the fall in value of the net investment in Subsidiary C, when measured against the functional currency of Parent (euro).

IE3 If the direct method of consolidation is used, the fall in the value of Parent's net investment in Subsidiary C of €24 million would be reflected totally in the foreign currency translation reserve relating to Subsidiary C in Parent's consolidated financial statements. However, because Parent uses the step-by-step method, this fall in the net investment value in Subsidiary C of €24 million would be reflected both in Subsidiary B's foreign currency translation reserve relating to Subsidiary C and in Parent's foreign currency translation reserve relating to Subsidiary B.

IE4 The aggregate amount recognised in the foreign currency translation reserve in respect of Subsidiaries B and C is not affected by the consolidation method. Assume that using the direct method of consolidation, the foreign currency translation reserves for Subsidiaries B and C in Parent's consolidated financial statements are €62 million gain and €24 million loss respectively; using the step-by-step method of consolidation those amounts are €49 million gain and €11 million loss respectively.

Reclassification

IE5 When the investment in Subsidiary C is disposed of, IAS 39 requires the full €24 million gain on the hedging instrument to be reclassified to profit or loss. Using the step-by-step method, the amount to be reclassified to profit or loss in respect of the net investment in Subsidiary C would be only €11 million loss. Parent could adjust the foreign currency translation reserves of both Subsidiaries B and C by €13 million in order to match the amounts reclassified in respect of the hedging instrument and the net investment as would have been the case if the direct method of consolidation had been used, if that was its accounting policy. An entity that had not hedged its net investment could make the same reclassification.

Basis for Conclusions on IFRIC Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*

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

HK(IFRIC)-Int 16 is based on IFRIC Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*. In approving HK(IFRIC)-Int 16, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 16. Accordingly, there are no significant differences between HK(IFRIC)-Int 16 and IFRIC Interpretation 16. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 16 referred to below generally correspond with those in HK(IFRIC)-Int 16.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background

BC2 The IFRIC was asked for guidance on accounting for the hedge of a net investment in a foreign operation in the consolidated financial statements. Interested parties had different views of the risks eligible for hedge accounting purposes. One issue is whether the risk arises from the foreign currency exposure to the functional currencies of the foreign operation and the parent entity, or whether it arises from the foreign currency exposure to the functional currency of the foreign operation and the presentation currency of the parent entity's consolidated financial statements.

BC3 Concern was also raised about which entity within a group could hold a hedging instrument in a hedge of a net investment in a foreign operation and in particular whether the parent entity holding the net investment in a foreign operation must also hold the hedging instrument.

BC4 Accordingly, the IFRIC decided to develop guidance on the accounting for a hedge of the foreign currency risk arising from a net investment in a foreign operation.

BC5 The IFRIC published draft Interpretation D22 *Hedges of a Net Investment in a Foreign Operation* for public comment in July 2007 and received 45 comment letters in response to its proposals.

Consensus

Hedged risk and hedged item

Functional currency versus presentation currency (paragraph 10)

BC6 The IFRIC received a submission suggesting that the method of consolidation can affect the determination of the hedged risk in a hedge of a net investment in a foreign operation. The submission noted that consolidation can be completed by either the direct method or the step-by-step method. In the direct method of consolidation, each entity within a group is consolidated directly into the ultimate parent entity's presentation currency when preparing the consolidated financial statements. In the step-by-step method, each intermediate parent entity prepares consolidated financial statements, which are then consolidated into its parent entity until the ultimate parent entity has prepared consolidated financial statements.

BC7 The submission stated that if the direct method was required, the risk that qualifies for hedge accounting in a hedge of a net investment in a foreign operation would arise only from exposure between the functional currency of the foreign operation and the presentation currency of the group. This is because each foreign operation is translated only once into the presentation currency. In contrast, the submission stated that if the step-by-step method was required, the hedged risk that qualifies for hedge accounting is the risk between the functional currencies of the foreign operation and the immediate parent entity into which the entity was consolidated. This is because each foreign operation is consolidated directly into its immediate parent entity.

BC8 In response to this, the IFRIC noted that IAS 21 *The Effects of Changes in Foreign Exchange Rates* does not specify a method of consolidation for foreign operations. Furthermore, paragraph BC18 of the Basis for Conclusions on IAS 21 states that the method of translating financial statements will result in the same amounts in the presentation currency regardless of whether the direct method or the step-by-step method is used. The IFRIC therefore concluded that the consolidation mechanism should not determine what risk qualifies for hedge accounting in the hedge of a net investment in a foreign operation.

BC9 However, the IFRIC noted that its conclusion would not resolve the divergence of views on the foreign currency risk that may be designated as a hedge relationship in the hedge of a net investment in a foreign operation. The IFRIC therefore decided that an Interpretation was needed.

BC10 The IFRIC considered whether the risk that qualifies for hedge accounting in a hedge of a net investment in a foreign operation arises from the exposure to the functional currency of the foreign operation in relation to the presentation currency of the group or the functional currency of the parent entity, or both.

BC11 The answer to this question is important when the presentation currency of the group is different from an intermediate or ultimate parent entity's functional currency. If the presentation currency of the group and the functional currency of the parent entity are the same, the exchange rate being hedged would be identified as that between the parent entity's functional currency and the foreign operation's functional currency. No further translation adjustment would be required to prepare the consolidated financial statements. However, when the functional currency of the parent entity is different from the presentation currency of the group, a translation adjustment will be included in other comprehensive income to present the consolidated financial statements in a different presentation currency. The issue, therefore, is how to determine which foreign currency risk may be designated as the hedged risk in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* in the hedge of a net investment in a foreign operation.

BC12 The IFRIC noted the following arguments for permitting hedge accounting for a hedge of the presentation currency:

(a) If the presentation currency of the group is different from the ultimate parent entity's functional currency, a difference arises on translation that is recognised in other comprehensive income. It is argued that a reason for allowing hedge accounting for a net investment in a foreign operation is to remove from the financial statements the fluctuations resulting from the translation to a presentation currency. If an entity is not allowed to use hedge accounting for the exposure to the presentation currency of the group when it is different from the functional currency of the parent entity, there is likely to be an amount included in other comprehensive income that cannot be offset by hedge accounting.

(b) IAS 21 requires an entity to reclassify from equity to profit or loss as a reclassification adjustment any foreign currency translation gains and losses included in other comprehensive income on disposal of a foreign operation. An amount in other comprehensive income arising from a different presentation currency is therefore included in the amount reclassified to profit or loss on disposal. The entity should be able to include the amount in a hedging relationship if at some stage it is recognised along with other reclassified translation amounts.

BC13 The IFRIC noted the following arguments for allowing an entity to designate hedging relationships solely on the basis of differences between functional currencies:

(a) The functional currency of an entity is determined on the basis of the primary economic environment in which that entity operates (ie the environment in which it generates and expends cash). However, the presentation currency is an elective currency that can be changed at any time. To present amounts in a presentation currency is merely a numerical convention necessary for the preparation of financial statements that include a foreign operation. The presentation currency will have no economic effect on the parent entity. Indeed, a parent entity may choose to present financial statements in more than one presentation currency, but can have only one functional currency.

(b) IAS 39 requires a hedging relationship to be effective in offsetting changes in fair values or cash flows attributable to the hedged risk. A net investment in a foreign operation gives rise to an exposure to changes in exchange rate risk for a parent entity. An economic exchange rate risk arises only from an exposure between two or more functional currencies, not from a presentation currency.

BC14 When comparing the arguments in paragraphs BC12 and BC13, the IFRIC concluded that the presentation currency does not create an exposure to which an entity may apply hedge accounting. The functional currency is determined on the basis of the primary economic environment in which the entity operates. Accordingly, functional currencies create an economic exposure to changes in cash flows or fair values; a presentation currency never will. No commentators on the draft Interpretation disagreed with the IFRIC's conclusion.

Eligible risk (paragraph 12)

BC15 The IFRIC considered which entity's (or entities') functional currency may be used as a reference point for the hedged risk in a net investment hedge. Does the risk arise from the functional currency of:

(a) the immediate parent entity that holds directly the foreign operation;

(b) the ultimate parent entity that is preparing its financial statements; or

(c) the immediate, an intermediate or the ultimate parent entity, depending on what risk that entity decides to hedge, as designated at the inception of the hedge?

BC16 The IFRIC concluded that the risk from the exposure to a different functional currency arises for any parent entity whose functional currency is different from that of the identified foreign operation. The immediate parent entity is exposed to changes in the exchange rate of its directly held foreign operation's functional currency. However, indirectly every entity up the chain of entities to the ultimate parent entity is also exposed to changes in the exchange rate of the foreign operation's functional currency.

BC17 Permitting only the ultimate parent entity to hedge its net investments would ignore the exposures arising on net investments in other parts of the entity. Conversely, permitting only the immediate parent entity to undertake a net investment hedge would imply that an indirect investment does not create a foreign currency exposure for that indirect parent entity.

BC18 The IFRIC concluded that a group must identify which risk (ie the functional currency of which parent entity and of which net investment in a foreign operation) is being hedged. The specified parent entity, the hedged risk and hedging instrument should all be designated and documented at the inception of the hedge relationship. As a result of comments received on the draft Interpretation, the IFRIC decided to emphasise that this documentation should also include the entity's strategy in undertaking the hedge as required by IAS 39.

Amount of hedged item that may be hedged (paragraphs 11 and 13)

BC19 In the draft Interpretation the IFRIC noted that, in financial statements that include a foreign operation, an entity cannot hedge the same risk more than once. This comment was intended to remind entities that IAS 39 does not permit multiple hedges of the same risk. Some respondents asked the IFRIC to clarify the situations in which the IFRIC considered that the same risk was being hedged more than once. In particular, the IFRIC was asked whether the same risk could be hedged by different entities within a group as long as the amount of risk being hedged was not duplicated.

BC20 In its redeliberations, the IFRIC decided to clarify that the carrying amount of the net assets of a foreign operation that may be hedged in the consolidated financial statements of a parent depends on whether any lower level parent of the foreign operation has hedged all or part of the net assets of that foreign operation and that accounting has been maintained in the parent's consolidated financial statements. An intermediate parent entity can hedge some or all of the risk of its net investment in a foreign operation in its own consolidated financial statements. However, such hedges will not qualify for hedge accounting at the ultimate parent entity level if the ultimate parent entity has also hedged the same risk. Alternatively, if the risk has not been hedged by the ultimate parent entity or another intermediate parent entity, the hedge relationship that qualified in the immediate parent entity's consolidated financial statements will also qualify in the ultimate parent entity's consolidated financial statements.

BC21 In its redeliberations, the IFRIC also decided to add guidance to the Interpretation to illustrate the importance of careful designation of the amount of the risk being hedged by each entity in the group.

Hedging instrument

Location of the hedging instrument (paragraph 14) and assessment of hedge effectiveness (paragraph 15)

BC22 The IFRIC discussed where in a group structure a hedging instrument may be held in a hedge of a net investment in a foreign operation. Guidance on the hedge of a net investment in a foreign operation was originally included in IAS 21. This guidance was moved to IAS 39 to ensure that the hedge accounting guidance included in paragraph 88 of IAS 39 would also apply to the hedges of net investments in foreign operations.

BC23 The IFRIC concluded that any entity within the group, other than the foreign operation being hedged, may hold the hedging instrument, as long as the hedging instrument is effective in offsetting the risk arising from the exposure to the functional currency of the foreign operation and the functional currency of the specified parent entity. The functional currency of the entity holding the instrument is irrelevant in determining effectiveness.

BC24 ~~The IFRIC concluded that the foreign operation being hedged could not hold the hedging instrument because that instrument would be part of, and denominated in the same currency as, the net investment it was intended to hedge. In this circumstance, hedge accounting is unnecessary. The foreign exchange differences between the parent's functional currency and both the hedging instrument and the functional currency of the net investment will automatically be included in the group's foreign currency translation reserve as part of the consolidation process. The balance of the discussion in this Basis for Conclusions does not repeat this restriction.~~*

BC24A Paragraph 14 of IFRIC 16 originally stated that the hedging instrument could not be held by the foreign operation whose net investment was being hedged. The restriction was included in draft Interpretation D22 (from which IFRIC 16 was developed) and attracted little comment from respondents. As originally explained in paragraph BC24, the IFRIC concluded, as part of

* Paragraph BC24 was deleted and paragraphs BC24A-BC24D and paragraph BC40A added as a consequence of *Improvements to IFRSs* issued in April 2009.

its redeliberations, that the restriction was appropriate because the foreign exchange differences between the parent's functional currency and both the hedging instrument and the functional currency of the net investment would automatically be included in the group's foreign currency translation reserve as part of the consolidation process.

BC24B After IFRIC 16 was issued, it was brought to the attention of the International Accounting Standards Board that this conclusion was not correct. Without hedge accounting, part of the foreign exchange difference arising from the hedging instrument would be included in consolidated profit or loss. Therefore, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 14 of IFRIC 16 to remove the restriction on the entity that can hold hedging instruments and deleted paragraph BC24.

BC24C Some respondents to the exposure draft *Post-implementation Revisions to IFRIC Interpretations* (ED/2009/1) agreed that a parent entity should be able to use a derivative held by the foreign operation being hedged as a hedge of the net investment in that foreign operation. However, those respondents recommended that the amendment should apply only to derivative instruments held by the foreign operation being hedged. They asserted that a non-derivative financial instrument would be an effective hedge of the net investment only if it were issued by the foreign operation in its own functional currency and this would have no foreign currency impact on the profit or loss of the consolidated group. Consequently, they thought that the rationale described in paragraph BC24B to support the amendment did not apply to non-derivative instruments.

BC24D In its redeliberations, the Board confirmed its previous decision that the amendment should not be restricted to derivative instruments. The Board noted that paragraphs AG13–AG15 of IFRIC 16 illustrate that a non-derivative instrument held by the foreign operation does not need to be considered to be part of the parent's net investment. As a result, even if it is denominated in the foreign operation's functional currency a non-derivative instrument could still affect the profit or loss of the consolidated group. Consequently, although it could be argued that the amendment was not required to permit non-derivative instruments to be designated as hedges, the Board decided that the proposal should not be changed.

BC25 The IFRIC also concluded that to apply the conclusion in paragraph BC23 when determining the effectiveness of a hedging instrument in the hedge of a net investment, an entity computes the gain or loss on the hedging instrument by reference to the functional currency of the parent entity against whose functional currency the hedged risk is measured, in accordance with the hedge documentation. This is the same regardless of the type of hedging instrument used. This ensures that the effectiveness of the instrument is determined on the basis of changes in fair value or cash flows of the hedging instrument, compared with the changes in the net investment as documented. Thus, any effectiveness test is not dependent on the functional currency of the entity holding the instrument. In other words, the fact that some of the change in the hedging instrument is recognised in profit or loss by one entity within the group and some is recognised in other comprehensive income by another does not affect the assessment of hedge effectiveness.

BC26 In the draft Interpretation the IFRIC noted Question F.2.14 in the guidance on implementing IAS 39, on the location of the hedging instrument, and considered whether that guidance could be applied by analogy to a net investment hedge. The answer to Question F.2.14 concludes:

> IAS 39 does not require that the operating unit that is exposed to the risk being hedged be a party to the hedging instrument.

This was the only basis for the IFRIC's conclusion regarding which entity could hold the hedging instrument provided in the draft Interpretation. Some respondents argued that the Interpretation should not refer to implementation guidance as the sole basis for an important conclusion.

BC27 In its redeliberations, the IFRIC considered both the International Accounting Standards Board's amendment to IAS 21 in 2005 and the objective of hedging a net investment described in IAS 39 in addition to the guidance on implementing IAS 39.

BC28 In 2005 the Board was asked to clarify which entity is the reporting entity in IAS 21 and therefore what instruments could be considered part of a reporting entity's net investment in a foreign operation. In particular, constituents questioned whether a monetary item must be transacted between the foreign operation and the reporting entity to be considered part of the net investment in accordance with IAS 21 paragraph 15, or whether it could be transacted between the foreign operation and any member of the consolidated group.

BC29 In response the Board added IAS 21 paragraph 15A to clarify that, 'The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 15 may be any subsidiary of the group.' The Board explained its reasons for the amendment in paragraph BC25D of the Basis for Conclusions:

> The Board concluded that the accounting treatment in the consolidated financial statements should not be dependent on the currency in which the monetary item is denominated, nor on which entity within the group conducts the transaction with the foreign operation.

In other words, the Board concluded that the relevant reporting entity is the group rather than the individual entity and that the net investment must be viewed from the perspective of the group. It follows, therefore, that the group's net investment in any foreign operation, and its foreign currency exposure, can be determined only at the relevant parent entity level. The IFRIC similarly concluded that the fact that the net investment is held through an intermediate entity does not affect the economic risk.

BC30 Consistently with the Board's conclusion with respect to monetary items that are part of *the net investment*, the IFRIC concluded that monetary items (or derivatives) that are *hedging instruments* in a hedge of a net investment may be held by any entity within the group and the functional currency of the entity holding the monetary items can be different from those of either the parent or the foreign operation. The IFRIC, like the Board, agreed with constituents who noted that a hedging item denominated in a currency that is not the functional currency of the entity holding it does not expose the group to a greater foreign currency exchange difference than arises when the instrument is denominated in that functional currency.

BC31 The IFRIC noted that its conclusions that the hedging instrument can be held by any entity in the group and that the foreign currency is determined at the relevant parent entity level have implications for the designation of hedged risks. As illustrated in paragraph AG5 of the application guidance, these conclusions make it possible for an entity to designate a hedged risk that is not apparent in the currencies of the hedged item or the foreign operation. This possibility is unique to hedges of net investments. Consequently, the IFRIC specified that the conclusions in the Interpretation should not be applied by analogy to other types of hedge accounting.

BC32 The IFRIC also noted that the objective of hedge accounting as set out in IAS 39 is to achieve offsetting changes in the values of the *hedging instrument* and of the *net investment* attributable to the hedged risk. Changes in foreign currency rates affect the value of the entire *net investment* in a foreign operation, not only the portion IAS 21 requires to be recognised in profit or loss in the absence of hedge accounting but also the portion recognised in other comprehensive income in the parent's consolidated financial statements. As noted in paragraph BC25, it is the total change in the hedging instrument as result of a change in the foreign currency rate with respect to the parent entity against whose functional currency the hedged risk is measured that is relevant, not the component of comprehensive income in which it is recognised.

Reclassification from other comprehensive income to profit or loss (paragraphs 16 and 17)

BC33 In response to requests from some respondents for clarification, the IFRIC discussed what amounts from the parent entity's foreign currency translation reserve in respect of both the hedging instrument and the foreign operation should be recognised in profit or loss in the parent entity's consolidated financial statements when the parent disposes of a foreign operation that was hedged. The IFRIC noted that the amounts to be reclassified from equity to profit or loss as reclassification adjustments on the disposition are:

(a) the cumulative amount of gain or loss on a hedging instrument determined to be an effective hedge that has been reflected in other comprehensive income (IAS 39 paragraph 102), and

(b) the cumulative amount reflected in the foreign currency translation reserve in respect of that foreign operation (IAS 21 paragraph 48).

BC34 The IFRIC noted that when an entity hedges a net investment in a foreign operation, IAS 39 requires it to identify the cumulative amount included in the group's foreign currency translation reserve as a result of applying hedge accounting, ie the amount determined to be an effective hedge. Therefore, the IFRIC concluded that when a foreign operation that was hedged is disposed of, the amount reclassified to profit or loss from the foreign currency translation reserve in respect of the hedging instrument in the consolidated financial statements of the parent should be the amount that IAS 39 requires to be identified.

Effect of consolidation method

BC35 Some respondents to the draft Interpretation argued that the method of consolidation creates a difference in the amounts included in the ultimate parent entity's foreign currency translation reserve for individual foreign operations that are held through intermediate parents. These respondents noted that this difference may become evident only when the ultimate parent entity disposes of a second tier subsidiary (ie an indirect subsidiary).

BC36 The difference becomes apparent in the determination of the amount of the foreign currency translation reserve that is subsequently reclassified to profit or loss. An ultimate parent entity using the direct method of consolidation would reclassify the cumulative foreign currency translation reserve that arose between its functional currency and that of the foreign operation. An ultimate parent entity using the step-by-step method of consolidation might reclassify the cumulative foreign currency translation reserve reflected in the financial statements of the intermediate parent, ie the amount that arose between the functional currency of the foreign operation and that of the intermediate parent, translated into the functional currency of the ultimate parent.

BC37 In its redeliberations, the IFRIC noted that the use of the step-by-step method of consolidation does create such a difference for an *individual* foreign operation although the aggregate net amount of foreign currency translation reserve for all the foreign operations is the same under either method of consolidation. At the same time, the IFRIC noted that the method of consolidation *should not* create such a difference for an individual foreign operation, on the basis of its conclusion that the economic risk is determined in relation to the ultimate parent's functional currency.

BC38 The IFRIC noted that the amount of foreign currency translation reserve for an individual foreign operation determined by the direct method of consolidation reflects the economic risk between the functional currency of the foreign operation and that of the ultimate parent (if the parent's functional and presentation currencies are the same). However, the IFRIC noted that IAS 21 does not require an entity to use this method or to make adjustments to produce the same result. The IFRIC also noted that a parent entity is not precluded from determining the amount of the foreign currency translation reserve in respect of a foreign operation it has disposed of as if the direct method of consolidation had been used in order to reclassify the appropriate amount to profit or loss. However, it also noted that making such an adjustment on the disposal of a foreign operation is an accounting policy choice and should be followed consistently for the disposal of all net investments.

BC39 The IFRIC noted that this issue arises when the net investment disposed of was not hedged and therefore is not strictly within the scope of the Interpretation. However, because it was a topic of considerable confusion and debate, the IFRIC decided to include a brief example illustrating its conclusions.

Transition (paragraph 19)

BC40 In response to respondents' comments, the IFRIC clarified the Interpretation's transitional requirements. The IFRIC decided that entities should apply the conclusions in this Interpretation to existing hedging relationships on adoption and cease hedge accounting for those that no longer qualify. However, previous hedge accounting is not affected. This is similar to the transition requirements in IFRS 1 *First-time Adoption of International Financial Reporting Standards* paragraph 30,* for relationships accounted for as hedges under previous GAAP.

Effective date of amended paragraph 14

BC40A The Board amended paragraph 14 in April 2009. In ED/2009/01 the Board proposed that the amendment should be effective for annual periods beginning on or after 1 October 2008, at the same time as IFRIC 16. Respondents to the exposure draft were concerned that permitting application before the amendment was issued might imply that an entity could designate hedge relationships retrospectively, contrary to the requirements of IAS 39. Consequently, the Board decided that an entity should apply the amendment to paragraph 14 made in April 2009 for annual periods beginning on or after 1 July 2009. The Board also decided to permit early application but noted that early application is possible only if the designation, documentation and effectiveness requirements of paragraph 88 of IAS 39 and of IFRIC 16 are satisfied at the application date.

Summary of main changes from the draft Interpretation

BC41 The main changes from the IFRIC's proposals are as follows:

(a) Paragraph 11 clarifies that the carrying amount of the net assets of a foreign operation that may be hedged in the consolidated financial statements of a parent depends on whether any lower level parent of the foreign operation has hedged all or part of the net assets of that foreign operation and that accounting has been maintained in the parent's consolidated financial statements.

(b) Paragraph 15 clarifies that the assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

(c) Paragraphs 16 and 17 and the illustrative example clarify what amounts should be reclassified from equity to profit or loss as reclassification adjustments on disposal of the foreign operation.

(d) Paragraph 19 clarifies transitional requirements.

(e) The appendix of application guidance was added to the Interpretation. Illustrative examples accompanying the draft Interpretation were removed.

(f) The Basis for Conclusions was changed to set out more clearly the reasons for the IFRIC's conclusions.

* Paragraph B6 in the revised version of IFRS 1 issued in November 2008.

HK(IFRIC)-Int 17
~~Issued December 2008~~Revised August 2010

Effective for annual periods
beginning on or after 1 July 2009

HK(IFRIC) Interpretation 17

Distributions of Non-cash Assets to Owners

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

CONTENTS

paragraphs

Hong Kong (IFRIC) Interpretation 17 *Distributions of Non-cash Assets to Owners* (HK(IFRIC)-Int 17) is set out in paragraphs 1–18 and the Appendix. HK(IFRIC)-Int 17 is accompanied by illustrative examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 17
Distributions of Non-cash Assets to Owners

References

- HKFRS 3 *Business Combinations* (as revised in 2008)
- HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
- HKFRS 7 *Financial Instruments: Disclosures*
- HKAS 1 *Presentation of Financial Statements* (as revised in 2007)
- HKAS 10 *Events after the Reporting Period*
- HKAS 27 *Consolidated and Separate Financial Statements* (as amended in October 2008)

Background

1 Sometimes an entity distributes assets other than cash (non-cash assets) as dividends to its owners[*] acting in their capacity as owners. In those situations, an entity may also give its owners a choice of receiving either non-cash assets or a cash alternative. Requests had been received for guidance on how an entity should account for such distributions.

2 Hong Kong Financial Reporting Standards (HKFRSs) do not provide guidance on how an entity should measure distributions to its owners (commonly referred to as dividends). HKAS 1 requires an entity to present details of dividends recognised as distributions to owners either in the statement of changes in equity or in the notes to the financial statements.

Scope

3 This Interpretation applies to the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:

(a) distributions of non-cash assets (eg items of property, plant and equipment, businesses as defined in HKFRS 3, ownership interests in another entity or disposal groups as defined in HKFRS 5); and

(b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

4 This Interpretation applies only to distributions in which all owners of the same class of equity instruments are treated equally.

5 This Interpretation does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution. This exclusion applies to the separate, individual and consolidated financial statements of an entity that makes the distribution.

6 In accordance with paragraph 5, this Interpretation does not apply when the non-cash asset is ultimately controlled by the same parties both before and after the distribution. Paragraph B2 of HKFRS 3 states that 'A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its

[*] Paragraph 7 of HKAS 1 defines owners as holders of instruments classified as equity.

financial and operating policies so as to obtain benefits from its activities.' Therefore, for a distribution to be outside the scope of this Interpretation on the basis that the same parties control the asset both before and after the distribution, a group of individual shareholders receiving the distribution must have, as a result of contractual arrangements, such ultimate collective power over the entity making the distribution.

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).

8 This Interpretation addresses only the accounting by an entity that makes a non-cash asset distribution. It does not address the accounting by shareholders who receive such a distribution.

Issues

9 When an entity declares a distribution and has an obligation to distribute the assets concerned to its owners, it must recognise a liability for the dividend payable. Consequently, this Interpretation addresses the following issues:

(a) When should the entity recognise the dividend payable?

(b) How should an entity measure the dividend payable?

(c) When an entity settles the dividend payable, how should it account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable?

Conclusions

When to recognise a dividend payable

10 The liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity, which is the date:

(a) when declaration of the dividend, eg by management or the board of directors, is approved by the relevant authority, eg the shareholders, if the jurisdiction requires such approval, or

(b) when the dividend is declared, eg by management or the board of directors, if the jurisdiction does not require further approval.

Measurement of a dividend payable

11 An entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed.

12 If an entity gives its owners a choice of receiving either a non-cash asset or a cash alternative, the entity shall estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative.

13 At the end of each reporting period and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable, with any changes in the carrying amount of the dividend payable recognised in equity as adjustments to the amount of the distribution.

Accounting for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when an entity settles the dividend payable

14 When an entity settles the dividend payable, it shall recognise the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss.

Presentation and disclosures

15 An entity shall present the difference described in paragraph 14 as a separate line item in profit or loss.

16 An entity shall disclose the following information, if applicable:

(a) the carrying amount of the dividend payable at the beginning and end of the period; and

(b) the increase or decrease in the carrying amount recognised in the period in accordance with paragraph 13 as result of a change in the fair value of the assets to be distributed.

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:

(a) the nature of the asset to be distributed;

(b) the carrying amount of the asset to be distributed as of the end of the reporting period; and

(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 used to determine that fair value required by HKFRS 7 paragraph 27(a) and (b).

Effective date

18 An entity shall apply this Interpretation prospectively for annual periods beginning on or after 1 July 2009. Retrospective application is not permitted. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 July 2009, it shall disclose that fact and also apply HKFRS 3 (as revised in 2008), HKAS 27 (as amended in October 2008) and HKFRS 5 (as amended by this Interpretation).

Appendix

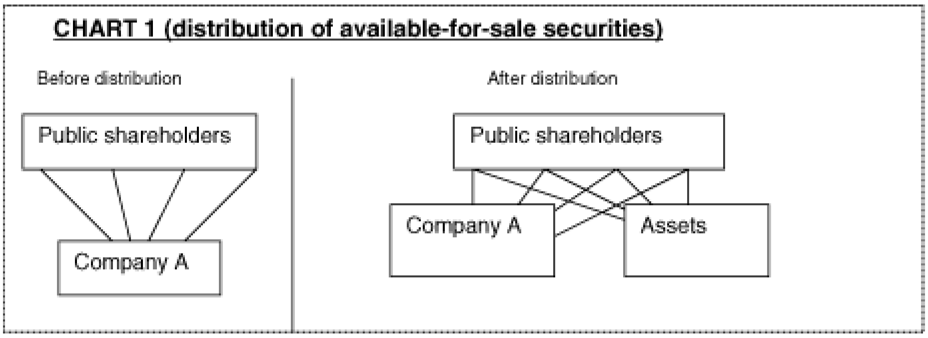
Amendments to HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and HKAS 10 *Events after the Reporting Period*

The amendments contained in this appendix when this Interpretation was issued in 2008 have been incorporated into HKFRS 5 and HKAS 10.

Illustrative examples

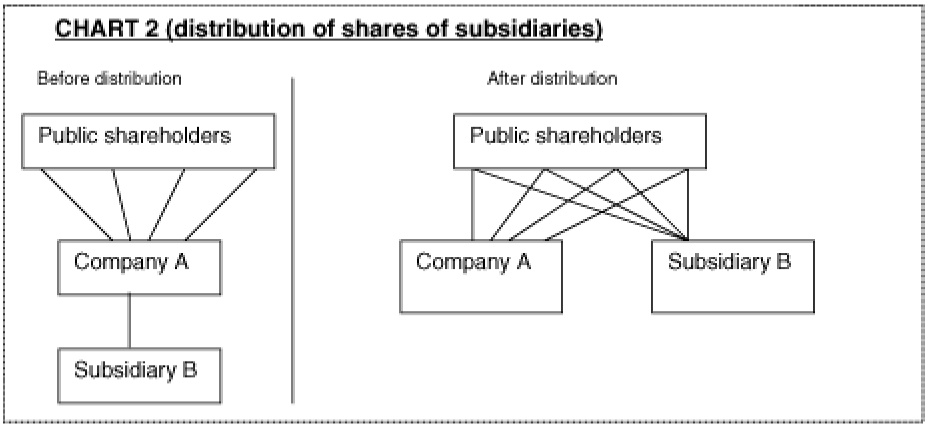
These examples accompany, but are not part of, IFRIC 17.

Scope of the Interpretation (paragraphs 3–8)



IE1 Assume Company A is owned by public shareholders. No single shareholder controls Company A and no group of shareholders is bound by a contractual agreement to act together to control Company A jointly. Company A distributes certain assets (eg available-for-sale securities) pro rata to the shareholders. This transaction is within the scope of the Interpretation.

IE2 However, if one of the shareholders (or a group bound by a contractual agreement to act together) controls Company A both before and after the transaction, the entire transaction (including the distributions to the non-controlling shareholders) is not within the scope of the Interpretation. This is because in a pro rata distribution to all owners of the same class of equity instruments, the controlling shareholder (or group of shareholders) will continue to control the non-cash assets after the distribution.



IE3 Assume Company A is owned by public shareholders. No single shareholder controls Company A and no group of shareholders is bound by a contractual agreement to act together to control Company A jointly. Company A owns all of the shares of Subsidiary B. Company A distributes all of the shares of Subsidiary B pro rata to its shareholders, thereby losing control of Subsidiary B. This transaction is within the scope of the Interpretation.

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 *Consolidated and Separate Financial Statements* (as amended in 2008). Company A controls Company B both before and after the transaction.

Basis for Conclusions on IFRIC Interpretation 17 *Distributions of Non-cash Assets to Owners*

This Basis for Conclusions accompanies, but is not part of, IFRIC 17.

HK(IFRIC)-Int 17 is based on IFRIC Interpretation 17 *Distributions of Non-cash Assets to Owners*. In approving HK(IFRIC)-Int 17, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 17. Accordingly, there are no significant differences between HK(IFRIC)-Int 17 and IFRIC Interpretation 17. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 17 referred to below generally correspond with those in HK(IFRIC)-Int 17.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 At present, International Financial Reporting Standards (IFRSs) do not address how an entity should measure distributions to owners acting in their capacity as owners (commonly referred to as dividends). The IFRIC was told that there was significant diversity in practice in how entities measured distributions of non-cash assets.

BC3 The IFRIC published draft Interpretation D23 *Distributions of Non-cash Assets to Owners* for public comment in January 2008 and received 56 comment letters in response to its proposals.

Scope (paragraphs 3–8)

Should the Interpretation address all transactions between an entity and its owners?

BC4 The IFRIC noted that an asset distribution by an entity to its owners is an example of a transaction between an entity and its owners. Transactions between an entity and its owners can generally be categorised into the following three types:

(a) exchange transactions between an entity and its owners.

(b) non-reciprocal transfers of assets by owners of an entity to the entity. Such transfers are commonly referred to as contributions from owners.

(c) non-reciprocal transfers of assets by an entity to its owners. Such transfers are commonly referred to as distributions to owners.

BC5 The IFRIC concluded that the Interpretation should not address exchange transactions between an entity and its owners because that would probably result in addressing all related party transactions. In the IFRIC's view, such a scope was too broad for an Interpretation. Instead, the IFRIC concluded that the Interpretation should focus on distributions of assets by an entity to its owners acting in their capacity as owners.

BC6 In addition, the IFRIC decided that the Interpretation should not address distributions in which owners of the same class of equity instrument are not all treated equally. This is because, in the IFRIC's view, such distributions might imply that at least some of the owners receiving the distributions indeed gave up something to the entity and/or other owners. In other words, such distributions might be more in the nature of exchange transactions.

Should the Interpretation address all types of asset distributions?

BC7 The IFRIC was told that there was significant diversity in the measurement of the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:

(a) distributions of non-cash assets (eg items of property, plant and equipment, businesses as defined in IFRS 3, ownership interests in another entity or disposal groups as defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) to its owners; and

(b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

BC8 The IFRIC noted that all distributions have the same purpose, ie to distribute assets to an entity's owners. It therefore concluded that the Interpretation should address the measurement of all types of asset distributions with one exception set out in paragraph 5 of the Interpretation.

A scope exclusion: a distribution of an asset that is ultimately controlled by the same party or parties before and after the distribution

BC9 In the Interpretation, the IFRIC considered whether it should address how an entity should measure a distribution of an asset (eg an ownership interest in a subsidiary) that is ultimately controlled by the same party or parties before and after the distribution. In many instances, such a distribution is for the purpose of group restructuring (eg separating two different businesses into two different subgroups). After the distribution, the asset is still controlled by the same party or parties.

BC10 In addition, the IFRIC noted that dealing with the accounting for a distribution of an asset within a group would require consideration of how a transfer of any asset within a group should be accounted for in the separate or individual financial statements of group entities.

BC11 For the reasons described in paragraphs BC9 and BC10, the IFRIC concluded that the Interpretation should not deal with a distribution of an asset that is ultimately controlled by the same party or parties before and after the distribution.

BC12 In response to comments received on the draft Interpretation, the IFRIC redeliberated whether the scope of the Interpretation should be expanded to include a distribution of an asset that is ultimately controlled by the same party or parties before and after the distribution. The IFRIC decided not to expand the scope of the Interpretation in the light of the Board's decision to add a project to its agenda to address common control transactions.

BC13 The IFRIC noted that many commentators believed that most distributions of assets to an entity's owners would be excluded from the scope of the Interpretation by paragraph 5. The IFRIC did not agree with this conclusion. It noted that in paragraph B2 of IFRS 3 *Business Combinations* (as revised in 2008), the Board concluded that a group of individuals would be regarded as controlling an entity only when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. In addition, in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* in May 2008, the Board clarified in the amendments to IAS 27 *Consolidated and Separate Financial Statements* that the distribution of equity interests in a new parent to shareholders in exchange for their interests in the existing parent was not a common control transaction.

BC14 Consequently, the IFRIC decided that the Interpretation should clarify that unless there is a contractual arrangement among shareholders to control the entity making the distribution, transactions in which the shares or the businesses of group entities are distributed to shareholders outside the group (commonly referred to as a spin-off, split-off or demerger) are not transactions between entities or businesses under common control. Therefore they are within the scope of the Interpretation.

BC15 Some commentators on D23 were concerned about situations in which an entity distributes some but not all of its ownership interests in a subsidiary and retains control. They believed that the proposed accounting for the distribution of ownership interests representing a non-controlling interest in accordance with D23 was inconsistent with the requirements of IAS 27 (as amended in 2008). That IFRS requires changes in a parent's ownership interest in a subsidiary that do not result in a loss of control to be accounted for as equity transactions. The IFRIC had not intended the Interpretation to apply to such transactions so did not believe it conflicted with the requirements of IAS 27. As a result of the concerns expressed, the IFRIC amended the Interpretation to make this clear.

BC16 Some commentators on D23 were also concerned about situations in which a subsidiary with a non-controlling interest distributes assets to both the parent and the non-controlling interests. They questioned why only the distribution to the controlling entity is excluded from the scope of the Interpretation. The IFRIC noted that when the parent controls the subsidiary before and after the transaction, the entire transaction (including the distribution to the non-controlling interest) is not within the scope of the Interpretation and is accounted for in accordance with IAS 27.

BC17 Distributions to owners may involve significant portions of an entity's operations. In such circumstances, sometimes referred to as split-off, some commentators on D23 were concerned that it would be difficult to determine which of the surviving entities had made the distribution. They thought that it might be possible for each surviving entity to recognise the distribution of the other. The IFRIC agreed with commentators that identifying the distributing entity might require judgement in some circumstances. However, the IFRIC concluded that the distribution could be recognised in only one entity's financial statements.

When to recognise a dividend payable (paragraph 10) and amendment to IAS 10

BC18 D23 did not address when an entity should recognise a liability for a dividend payable and some respondents asked the IFRIC to clarify this issue. The IFRIC noted that in IAS 10 *Events after the Reporting Period* paragraph 13 states that 'If dividends are declared (ie the dividends are appropriately authorised and no longer at the discretion of the entity) after the reporting period but before the financial statements are authorised for issue, the dividends are not recognised as a liability at the end of the reporting period because no obligation exists at that time'.

BC19 Some commentators stated that in many jurisdictions a commonly held view is that the entity has discretion until the shareholders approve the dividend. Therefore, constituents holding this view believe a conflict exists between 'declared' and the explanatory phrase in the brackets in IAS 10 paragraph 13. This is especially true when the sentence is interpreted as 'declared by *management but before the shareholders' approval*'. The IFRIC concluded that the point at which a dividend is appropriately authorised and no longer at the discretion of the entity will vary by jurisdiction.

BC20 Therefore, as a consequence of this Interpretation the IFRIC decided to recommend that the Board amend IAS 10 to remove the perceived conflict in paragraph 13. The IFRIC also noted that the principle on when to recognise a dividend was in the wrong place within the IASB's authoritative documents. The Board agreed with the IFRIC's conclusions and amended IAS 10 as part of its approval of the Interpretation. The Board confirmed that this Interpretation had not changed the principle on when to recognise a dividend payable; however, the principle was moved from IAS 10 into the Interpretation and clarified but without changing the principle.

How should an entity measure a dividend payable? (paragraphs 11–13)

BC21 IFRSs do not provide guidance on how an entity should measure distributions to owners. However, the IFRIC noted that a number of IFRSs address how a liability should be measured. Although IFRSs do not specifically address how an entity should measure a dividend payable, the IFRIC decided that it could identify potentially relevant IFRSs and apply their principles to determine the appropriate measurement basis.

Which IFRSs are relevant to the measurement of a dividend payable?

BC22 The IFRIC considered all IFRSs that prescribe the accounting for a liability. Of those, the IFRIC concluded that IAS 37 *Provisions, Contingent Assets and Contingent Liabilities* and IAS 39 *Financial Instruments: Recognition and Measurement* were the most likely to be relevant. The IFRIC concluded that other IFRSs were not applicable because most of them addressed only liabilities arising from exchange transactions and some of them were clearly not relevant (eg IAS 12 *Income Taxes*). As mentioned above, the Interpretation addresses only non-reciprocal distributions of assets by an entity to its owners.

BC23 Given that all types of distributions have the purpose of distributing assets to owners, the IFRIC decided that all dividends payable should be measured the same way, regardless of the types of assets to be distributed. This also ensures that all dividends payable are measured consistently.

BC24 Some believed that IAS 39 was the appropriate IFRS to be used to measure dividends payable. They believed that, once an entity declared a distribution to its owners, it had a contractual obligation to distribute the assets to its owners. However, IAS 39 would not cover dividends payable if they were considered to be non-contractual obligations. In addition, IAS 39 covers some but not all obligations that require an entity to deliver non-cash assets to another entity. It does not cover a liability to distribute non-financial assets to owners. The IFRIC therefore concluded that it was not appropriate to conclude that all dividends payable should be within the scope of IAS 39.

BC25 The IFRIC then considered IAS 37, which is generally applied in practice to determine the accounting for liabilities other than those arising from executory contracts and those addressed by other IFRSs. IAS 37 requires an entity to measure a liability on the basis of the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Consequently, in D23 the IFRIC decided that it was appropriate to apply the principles in IAS 37 to all dividends payable (regardless of the types of assets to be distributed). The IFRIC decided that to apply IAS 37 to measure a liability for an obligation to distribute non-cash assets to owners, an entity should consider the fair value of the assets to be distributed. The fair value of the assets to be distributed is clearly relevant no matter which approach in IAS 37 is taken to determine the best estimate of the expenditure required to settle the liability.

BC26 However, in response to comments received on D23, the IFRIC reconsidered whether the Interpretation should specify that all dividends payable should be measured in accordance with IAS 37. The IFRIC noted that many respondents were concerned that D23 might imply that the measurement attribute in IAS 37 should always be interpreted to be fair value. This was not the intention of D23 as that question is part of the Board's project to amend IAS 37. In addition, many respondents were not certain whether measuring the dividend payable 'by reference to' the fair value of the assets to be distributed required measurement at their fair value or at some other amount.

BC27 Therefore, the IFRIC decided to modify the proposal in D23 to require the dividend payable to be measured at the fair value of the assets to be distributed, without linking to any individual standard its conclusion that fair value is the most relevant measurement attribute. The IFRIC also noted that if the assets being distributed constituted a business, its fair value could be different from the simple sum of the fair value of the component assets and liabilities (ie it includes the value of goodwill or the identified intangible assets).

Should any exception be made to the principle of measuring a dividend payable at the fair value of the assets to be distributed?

BC28 Some are concerned that the fair value of the assets to be distributed might not be reliably measurable in all cases. They believe that exceptions should be made in the following circumstances:

(a) An entity distributes an ownership interest of another entity that is not traded in an active market and the fair value of the ownership interest cannot be measured reliably. The IFRIC noted that IAS 39 does not permit investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be measured reliably to be measured at fair value.

(b) An entity distributes an intangible asset that is not traded in an active market and therefore would not be permitted to be carried at a revalued amount in accordance with IAS 38 *Intangible Assets*.

BC29 The IFRIC noted that in accordance with IAS 39 paragraphs AG80 and AG81, the fair value of equity instruments that do not have a quoted price in an active market is reliably measurable if:

(a) the variability in the range of reasonable fair value estimates 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 fair value.

BC30 The IFRIC noted that, when the management of an entity recommends a distribution of a non-cash asset to its owners, one or both of the conditions for determining a reliable measure of the fair value of equity instruments that do not have a quoted price in an active market is likely to be satisfied. Management would be expected to know the fair value of the asset because management has to ensure that all owners of the entity are informed of the value of the distribution. For this reason, it would be difficult to argue that the fair value of the assets to be distributed cannot be determined reliably.

BC31 In addition, the IFRIC recognised that in some cases the fair value of an asset must be estimated. As mentioned in paragraph 86 of the *Framework for the Preparation and Presentation of Financial Statements*, the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

BC32 The IFRIC noted that a reason why IAS 38 and IAS 39 require some assets to be measured using a historical cost basis is cost-benefit considerations. The cost of determining the fair value of an asset not traded in an active market at the end of each reporting period could outweigh the benefits. However, because an entity would be required to determine the fair value of the assets to be distributed only once at the time of distribution, the IFRIC concluded that the benefit (ie informing users of the financial statements of the value of the assets distributed) outweighs the cost of determining the fair value of the assets.

BC33 Furthermore, the IFRIC noted that dividend income, regardless of whether it is in the form of cash or non-cash assets, is within the scope of IAS 18 *Revenue* and is required to be measured at the fair value of the consideration received. Although the Interpretation does not address the accounting by the recipient of the non-cash distribution, the IFRIC concluded that the Interpretation did not impose a more onerous requirement on the entity that makes the distribution than IFRSs have already imposed on the recipient of the distribution.

BC34 For the reasons described in paragraphs BC28–BC33, the IFRIC concluded that no exceptions should be made to the requirement that the fair value of the asset to be distributed should be used in measuring a dividend payable.

Whether an entity should remeasure the dividend payable (paragraph 13)

BC35 The IFRIC noted that paragraph 59 of IAS 37 requires an entity to review the carrying amount of a liability at the end of each reporting period and to adjust the carrying amount to reflect the current best estimate of the liability. Other IFRSs such as IAS 19 *Employee Benefits* similarly require liabilities that are based on estimates to be adjusted each reporting period. The IFRIC therefore decided that the entity should review and adjust the carrying amount of the dividend payable to reflect its current best estimate of the fair value of the assets to be distributed at the end of each reporting period and at the date of settlement.

BC36 The IFRIC concluded that, because any adjustments to the best estimate of the dividend payable reflect changes in the estimated value of the distribution, they should be recognised as adjustments to the amount of the distribution. In accordance with IAS 1 *Presentation of Financial Statements* (as revised in 2007), distributions to owners are required to be recognised directly in the statement of changes in equity. Similarly, adjustments to the amount of the distribution are also recognised directly in the statement of changes in equity.

BC37 Some commentators argued that the changes in the estimated value of the distribution should be recognised in profit or loss because changes in liabilities meet the definition of income or expenses in the *Framework*. However, the IFRIC decided that the gain or loss on the assets to be distributed should be recognised in profit or loss when the dividend payable is settled. This is consistent with other IFRSs (IAS 16, IAS 38, IAS 39) that require an entity to recognise in profit or loss any gain or loss arising from derecognition of an asset. The IFRIC concluded that the changes in the dividend payable before settlement related to changes in the estimate of the distribution and should be accounted for in equity (ie adjustments to the amount of the distribution) until settlement of the dividend payable.

When the entity settles the dividend payable, how should it account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable? (paragraph 14)

BC38 When an entity distributes the assets to its owners, it derecognises both the assets distributed and the dividend payable.

BC39 The IFRIC noted that, at the time of settlement, the carrying amount of the assets distributed would not normally be greater than the carrying amount of the dividend payable because of the recognition of impairment losses required by other applicable standards. For example, paragraph 59 of IAS 36 *Impairment of Assets* requires an entity to recognise an impairment loss in profit or loss when the recoverable amount of an asset is less than its carrying amount. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use in accordance with paragraph 6 of IAS 36. When an entity has an obligation to distribute the asset to its owners in the near future, it would not seem appropriate to measure an impairment loss using the asset's value in use. Furthermore, IFRS 5 requires an entity to measure an asset held for sale at the lower of its carrying amount and its fair value less costs to sell. Consequently, the IFRIC concluded that when an entity derecognises the dividend payable and the asset distributed, any difference will always be a credit balance (referred to below as the credit balance).

BC40 In determining how the credit balance should be accounted for, the IFRIC first considered whether it should be recognised as an owner change in equity.

BC41 The IFRIC acknowledged that an asset distribution was a transaction between an entity and its owners. The IFRIC also observed that distributions to owners are recognised as owner changes in equity in accordance with IAS 1 (as revised in 2007). However, the IFRIC noted that the credit balance did not arise from the distribution transaction. Rather, it represented the cumulative unrecognised gain associated with the asset. It reflects the performance of the entity during the period the asset was held until it was distributed.

BC42 Some might argue that, since an asset distribution does not result in the owners of an entity losing the future economic benefits of the asset, the credit balance should be recognised directly in equity. This view would be based upon the proprietary perspective in which the reporting entity does not have substance of its own separate from that of its owners. However, the IFRIC noted that the *Framework* requires an entity to consider the effect of a transaction from the perspective of the entity for which the financial statements are prepared. Under the entity perspective, the reporting entity has substance of its own, separate from that of its owners. In addition, when there is more than one class of equity instruments, the argument that all owners of an entity have effectively the same interest in the asset would not be valid.

BC43 For the reasons described in paragraphs BC41 and BC42, the IFRIC concluded that the credit balance should not be recognised as an owner change in equity.

BC44 The IFRIC noted that, as explained in the Basis for Conclusions on IAS 1, the Board explicitly prohibited any income or expenses (ie non-owner changes in equity) from being recognised directly in the statement of changes in equity. Any such income or expenses must be recognised as items of comprehensive income first.

BC45 The statement of comprehensive income in accordance with IAS 1 includes two components: items of profit or loss, and items of other comprehensive income. The IFRIC therefore discussed whether the credit balance should be recognised in profit or loss or in other comprehensive income.

BC46 IAS 1 does not provide criteria for when an item should be recognised in profit or loss. However, paragraph 88 of IAS 1 states: 'An entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise.'

BC47 The IFRIC considered the circumstances in which IFRSs require items of income and expense to be recognised as items of other comprehensive income, mainly as follows:

(a) some actuarial gains or losses arising from remeasuring defined benefit liabilities provided that specific criteria set out in IAS 19 are met.

(b) a revaluation surplus arising from revaluation of an item of property, plant and equipment in accordance with IAS 16 or revaluation of an intangible asset in accordance with IAS 38.

(c) an exchange difference arising from the translation of the results and financial positions of an entity from its functional currency into a presentation currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

(d) an exchange difference arising from the translation of the results and financial position of a foreign operation into a presentation currency of a reporting entity for consolidation purposes in accordance with IAS 21.

(e) a change in the fair value of an available-for-sale investment in accordance with IAS 39.

(f) a change in the fair value of a hedging instrument qualifying for cash flow hedge accounting in accordance with IAS 39.

BC48 The IFRIC concluded that the requirement in IAS 1 prevents any of these items from being applied by analogy to the credit balance. In addition, the IFRIC noted that, with the exception of the items described in paragraph BC47(a)–(c), the applicable IFRSs require the items of income and expenses listed in paragraph BC47 to be reclassified to profit or loss when the related assets or liabilities are derecognised. Those items of income and expenses are recognised as items of other comprehensive income when incurred, deferred in equity until the related assets are disposed of (or the related liabilities are settled), and reclassified to profit or loss at that time.

BC49 The IFRIC noted that, when the dividend payable is settled, the asset distributed is also derecognised. Therefore, given the existing requirements in IFRSs, even if the credit balance were recognised as an item of other comprehensive income, it would have to be reclassified to profit or loss immediately. As a result, the credit balance would appear three times in the statement of comprehensive income—once recognised as an item of other comprehensive income, once reclassified out of other comprehensive income to profit or loss and once recognised as an item of profit or loss as a result of the reclassification. The IFRIC concluded that such a presentation does not faithfully reflect what has occurred. In addition, users of financial statements were likely to be confused by such a presentation.

BC50 Moreover, when an entity distributes its assets to its owners, it loses the future economic benefit associated with the assets distributed and derecognises those assets. Such a consequence is, in general, similar to that of a disposal of an asset. IFRSs (eg IAS 16, IAS 38, IAS 39 and IFRS 5) require an entity to recognise in profit or loss any gain or loss arising from the derecognition of an asset. IFRSs also require such a gain or loss to be recognised when the asset is derecognised. As mentioned in paragraph BC42, the *Framework* requires an entity to consider the effect of a transaction from the perspective of an entity for which the financial statements are prepared. For these reasons, the IFRIC concluded that the credit balance and gains or losses on derecognition of an asset should be accounted for in the same way.

BC51 Furthermore, paragraph 92 of the *Framework* states: 'Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or *a decrease of a liability* has arisen that can be measured reliably' (emphasis added). At the time of the settlement of a dividend payable, there is clearly a decrease in a liability. Therefore, the credit balance should be recognised in profit or loss in accordance with paragraph 92 of the *Framework*. Some might argue that the entity does not receive any additional economic benefits when it distributes the assets to its owners. As mentioned in paragraph BC41, the credit balance does not represent any additional economic benefits to the entity. Instead, it represents the unrecognised economic benefits that the entity obtained while it held the assets.

BC52 The IFRIC also noted that paragraph 55 of the *Framework* states: 'The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be: (a) used singly or in combination with other assets in the production of goods or services to be sold by the entity; (b) exchanged for other assets; (c) used to settle a liability; or (d) *distributed to the owners of the entity* [emphasis added].'

BC53 In the light of these requirements, in D23 the IFRIC concluded that the credit balance should be recognised in profit or loss. This treatment would give rise to the same accounting results regardless of whether an entity distributes non-cash assets to its owners, or sells the non-cash assets first and distributes the cash received to its owners. Most commentators on D23 supported the IFRIC's conclusion and its basis.

BC54 Some IFRIC members believed that it would be more appropriate to treat the distribution as a single transaction with owners and therefore recognise the credit balance directly in equity. This alternative view was included in D23 and comments were specifically invited. However, this view was not supported by commentators. To be recognised directly in equity, the credit balance must be considered an owner change in equity in accordance with IAS 1. The IFRIC decided that the credit balance does not arise from the distribution transaction. Rather, it represents the increase in value of the assets. The increase in the value of the asset does not meet the definition of an owner change in equity in accordance with IAS 1. Rather, it meets the definition of income and should be recognised in profit and loss.

BC55 The IFRIC recognised respondents' concerns about the potential 'accounting mismatch' in equity resulting from measuring the assets to be distributed at carrying amount and measuring the dividend payable at fair value. Consequently, the IFRIC considered whether it should recommend that the Board amend IFRS 5 to require the assets to be distributed to be measured at fair value.

BC56 In general, IFRSs permit remeasurement of assets only as the result of a transaction or an impairment. The exceptions are situations in which the IFRSs prescribe current measures on an ongoing basis as in IASs 39 and 41 *Agriculture*, or permit them as accounting policy choices as in IASs 16, 38 and 40 *Investment Property*. As a result of its redeliberations, the IFRIC concluded that there was no support in IFRSs for requiring a remeasurement of the assets because of a decision to distribute them. The IFRIC noted that the mismatch concerned arises only with respect to assets that are not carried at fair value already. The IFRIC also noted that the accounting mismatch is the inevitable consequence of IFRSs using different measurement attributes at different times with different triggers for the remeasurement of different assets and liabilities.

BC57 If a business is to be distributed, the fair value means the fair value of the business to be distributed. Therefore, it includes goodwill and intangible assets. However, internally generated goodwill is not permitted to be recognised as an asset (paragraph 48 of IAS 38). Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance are not permitted to be recognised as intangible assets (paragraph 63 of IAS 38). In accordance with IAS 38, the carrying amounts of internally generated intangible assets are generally restricted to the sum of expenditure incurred by an entity. Consequently, a requirement to remeasure an asset that is a business would contradict the relevant requirements in IAS 38.

BC58 Furthermore, in addition to the lack of consistency with other IFRSs, changing IFRS 5 this way (ie to require an asset held for distribution to owners to be remeasured at fair value) would create internal inconsistency within IFRS 5. There would be no reasonable rationale to explain why IFRS 5 could require assets that are to be sold to be carried at the lower of fair value less costs to sell and carrying value but assets to be distributed to owners to be carried at fair value. The IFRIC also noted that this ‘mismatch’ would arise only in the normally short period between when the dividend payable is recognised and when it is settled. The length of this period would often be within the control of management. Therefore, the IFRIC decided not to recommend that the Board amend IFRS 5 to require assets that are to be distributed to be measured at fair value.

Amendment to IFRS 5

BC59 IFRS 5 requires an entity to classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. IFRS 5 also sets out presentation and disclosure requirements for a discontinued operation.

BC60 When an entity has an obligation to distribute assets to its owners, the carrying amount of the assets will no longer be recovered principally through continuing use. The IFRIC decided that the information required by IFRS 5 is important to users of financial statements regardless of the form of a transaction. Therefore, the IFRIC concluded that the requirements in IFRS 5 applicable to non-current assets (or disposal groups) classified as held for sale and to discontinued operations should also be applied to assets (or disposal groups) held for distribution to owners.

BC61 However, the IFRIC concluded that requiring an entity to apply IFRS 5 to non-current assets (disposal groups) held for distribution to owners would require amendments to IFRS 5. This is because, in the IFRIC’s view, IFRS 5 at present applies only to non-current assets (disposal groups) held for sale.

BC62 The Board discussed the IFRIC’s proposal at its meeting in December 2007. The Board agreed with the IFRIC’s conclusion that IFRS 5 should be amended to apply to non-current assets held for distribution to owners as well as to assets held for sale. However, the Board noted that IFRS 5 requires an entity to classify a non-current asset as held for sale when the sale is highly probable and the entity is *committed* to a plan to sell (emphasis added). Consequently, the Board directed the IFRIC to invite comments on the following questions:

(a) Should an entity apply IFRS 5 when it is committed to make a distribution or when it has an obligation to distribute the assets concerned?

(b) Is there a difference between those dates?

(c) If respondents believe that there is a difference between the dates and that an entity should apply IFRS 5 at the commitment date, what is the difference? What indicators should be included in IFRS 5 to help an entity to determine that date?

BC63 On the basis of the comments received, the IFRIC noted that, in many jurisdictions, shareholders' approval is required to make a distribution. Therefore, in such jurisdictions there could be a difference between the commitment date (ie the date when management is committed to the dividend) and the obligation date (ie the date when the dividend is approved by the shareholders). On the other hand, some commentators think that, when a distribution requires shareholders' approval, the entity cannot be committed until that approval is obtained: in that case, there would be no difference between two dates.

BC64 The IFRIC concluded that IFRS 5 should be applied at the commitment date at which time the assets must be available for immediate distribution in their present condition and the distribution must be *highly probable*. For the distribution to be highly probable, it should meet essentially the same conditions required for assets held for sale. Further, the IFRIC concluded that the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable. The IFRIC noted that shareholder approval is also required for the sale of assets in some jurisdictions and concluded that similar consideration of the probability of such approval should be required for assets held for sale.

BC65 The Board agreed with the IFRIC's conclusions and amended IFRS 5 as part of its approval of the Interpretation.

Summary of main changes from the draft Interpretation

BC66 The main changes from the IFRIC's proposals in D23 are as follows:

(a) Paragraphs 3–8 were modified to clarify the scope of the Interpretation.

(b) Paragraph 10 clarifies when to recognise a dividend payable.

(c) Paragraphs 11–13 were modified to require the dividend payable to be measured at the fair value of the assets to be distributed without linking the IFRIC's conclusion that fair value is the most relevant measurement attribute to any individual standard.

(d) Illustrative examples were expanded to set out clearly the scope of the Interpretation.

(e) The Interpretation includes the amendments to IFRS 5 and IAS 10.

(f) The Basis for Conclusions was changed to set out more clearly the reasons for the IFRIC's conclusions.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Interpretation resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Interpretation and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013

The Basis for Conclusions on IFRIC 17 is amended as described below.

In paragraph BC22 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the IASB 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*. IFRS 9 applies to all assets within the scope of IAS 39.

Paragraph BC28(a) is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, requires all investments in equity instruments to be measured at fair value.

In paragraph BC29 the reference to paragraph AG81 is footnoted 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.

In paragraph BC32 the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the requirement in IAS 39 for some assets to be measured using a historical cost basis.

In paragraph BC47(e) the reference to 'available-for-sale' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

Illustrative examples

These examples accompany, but are not part of, IFRIC 18.

Example 1

IE1 A real estate company is building a residential development in an area that is not connected to the electricity network. In order to have access to the electricity network, the real estate company is required to construct an electricity substation that is then transferred to the network company responsible for the transmission of electricity. It is assumed in this example that the network company concludes that the transferred substation meets the definition of an asset. The network company then uses the substation to connect each house of the residential development to its electricity network. In this case, it is the homeowners that will eventually use the network to access the supply of electricity, although they did not initially transfer the substation. By regulation, the network company has an obligation to provide ongoing access to the network to all users of the network at the same price, regardless of whether they transferred an asset. Therefore, users of the network that transfer an asset to the network company pay the same price for the use of the network as those that do not. Users of the network can choose to purchase their electricity from distributors other than the network company but must use the company's network to access the supply of electricity.

IE2 Alternatively, the network company could have constructed the substation and received a transfer of an amount of cash from the real estate company that had to be used only for the construction of the substation. The amount of cash transferred would not necessarily equal the entire cost of the substation. It is assumed that the substation remains an asset of the network company.

IE3 In this example, the Interpretation applies to the network company that receives the electricity substation from the real estate company. The network company recognises the substation as an item of property, plant and equipment and measures its cost on initial recognition at its fair value (or at its construction cost in the circumstances described in paragraph IE2) in accordance with IAS 16 *Property, Plant and Equipment*. The fact that users of the network that transfer an asset to the network company pay the same price for the use of the electricity network as those that do not indicates that the obligation to provide ongoing access to the network is not a separately identifiable service of the transaction. Rather, connecting the house to the network is the only service to be delivered in exchange for the substation. Therefore, the network company should recognise revenue from the exchange transaction at the fair value of the substation (or at the amount of the cash received from the real estate company in the circumstances described in paragraph IE2) when the houses are connected to the network in accordance with in paragraph 20 of IAS 18 *Revenue*.

Example 2

IE4 A house builder constructs a house on a redeveloped site in a major city. As part of constructing the house, the house builder installs a pipe from the house to the water main in front of the house. Because the pipe is on the house's land, the owner of the house can restrict access to the pipe. The owner is also responsible for the maintenance of the pipe. In this example, the facts indicate that the definition of an asset is not met for the water company.

IE5 Alternatively, a house builder constructs multiple houses and installs a pipe on the commonly owned or public land to connect the houses to the water main. The house builder transfers ownership of the pipe to the water company that will be responsible for its maintenance. In this example, the facts indicate that the water company controls the pipe and should recognise it.

Example 3

IE6 An entity enters into an agreement with a customer involving the outsourcing of the customer's information technology (IT) functions. As part of the agreement, the customer transfers ownership of its existing IT equipment to the entity. Initially, the entity must use the equipment to provide the service required by the outsourcing agreement. The entity is responsible for maintaining the equipment and for replacing it when the entity decides to do so. The useful life of the equipment is estimated to be three years. The outsourcing agreement requires service to be provided for ten years for a fixed price that is lower than the price the entity would have charged if the IT equipment had not been transferred.

IE7 In this example, the facts indicate that the IT equipment is an asset of the entity. Therefore, the entity should recognise the equipment and measure its cost on initial recognition at its fair value in accordance with paragraph 24 of IAS 16. The fact that the price charged for the service to be provided under the outsourcing agreement is lower than the price the entity would charge without the transfer of the IT equipment indicates that this service is a separately identifiable service included in the agreement. The facts also indicate that it is the only service to be provided in exchange for the transfer of the IT equipment. Therefore, the entity should recognise revenue arising from the exchange transaction when the service is performed, ie over the ten-year term of the outsourcing agreement.

IE8 Alternatively, assume that after the first three years, the price the entity charges under the outsourcing agreement increases to reflect the fact that it will then be replacing the equipment the customer transferred.

IE9 In this case, the reduced price for the services provided under the outsourcing agreement reflects the useful life of the transferred equipment. For this reason, the entity should recognise revenue from the exchange transaction over the first three years of the agreement.

HK(SIC)-Int 10
~~Issued December 2004~~Revised August 2010

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 10

Government Assistance — No Specific Relation to Operating Activities

Hong Kong Institute of
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香港會計師公會

Hong Kong (SIC) Interpretation 10
Government Assistance - No Specific Relation to Operating Activities

HK(SIC) Interpretation 10 *Government Assistance - No Specific Relation to Operating Activities* (HK(SIC)-Int 10) is set out in paragraph 3. HK(SIC)-Int 10 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards.*

References

- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

Issue

1 In some countries government assistance to entities may be aimed at encouragement or long-term support of business activities either in certain regions or industry sectors. Conditions to receive such assistance may not be specifically related to the operating activities of the entity. Examples of such assistance are transfers of resources by governments to entities which:

(a) operate in a particular industry;

(b) continue operating in recently privatised industries; or

(c) start or continue to run their business in underdeveloped areas.

2 The issue is whether such government assistance is a 'government grant' within the scope of HKAS 20 and, therefore, shall be accounted for in accordance with this Standard.

Conclusion

3 Government assistance to entities meets the definition of government grants in HKAS 20, even if there are no conditions specifically relating to the operating activities of the entity other than the requirement to operate in certain regions or industry sectors. Such grants shall therefore not be credited directly to ~~equity~~shareholders' interests.

Basis for Conclusions

HK(SIC)-Int 10 is based on SIC Interpretation 10 *Government Assistance - No Specific Relation to Operating Activities*. In approving HK(SIC)-Int 10, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 10. Accordingly, there are no significant differences between HK(SIC)-Int 10 and SIC Interpretation 10. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 10 referred to below generally correspond with those in HK(SIC)-Int 10.

4 IAS 20.03 defines government grants as assistance by the government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. The general requirement to operate in certain regions or industry sectors in order to qualify for the government assistance constitutes such a condition in accordance with IAS 20.03. Therefore, such assistance falls within the definition of government grants and the requirements of IAS 20 apply, in particular paragraphs 12 and 20, which deal with the timing of recognition as income.

Date of Issue

December 2004

Effective date

This Interpretation becomes effective for annual accounting periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies shall be accounted for in accordance with HKAS 8.

This Interpretation supersedes the last sentence of paragraph 5 of SSAP 35 *Accounting for Government Grants and Disclosure of Government Assistance* (issued in March 2002).

HK(SIC)-Int 13
~~Issued December 2004~~Revised August 2010

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 13

Jointly Controlled Entities — Non-Monetary Contributions by Venturers

Hong Kong Institute of
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Hong Kong (SIC) Interpretation 13
Jointly Controlled Entities - Non-Monetary Contributions by Venturers

HK(SIC) Interpretation 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* (HK(SIC)-Int 13) is set out in paragraphs 5-7. HK(SIC)-Int 13 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards.*

References

- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 18 *Revenue*
- HKAS 31 *Interests in Joint Ventures*

Issue

1 HKAS 31.48 refers to both contributions and sales between a venturer and a joint venture as follows: 'When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction'. In addition, HKAS 31.24 says that 'a jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest'. There is no explicit guidance on the recognition of gains and losses resulting from contributions of non-monetary assets to jointly controlled entities ('JCEs').

2 Contributions to a JCE are transfers of assets by venturers in exchange for an equity interest in the JCE. Such contributions may take various forms. Contributions may be made simultaneously by the venturers either upon establishing the JCE or subsequently. The consideration received by the venturer(s) in exchange for assets contributed to the JCE may also include cash or other consideration that does not depend on future cash flows of the JCE ('additional consideration').

3 The issues are:

(a) when the appropriate portion of gains or losses resulting from a contribution of a non-monetary asset to a JCE in exchange for an equity interest in the JCE should be recognised by the venturer in ~~the income statement~~profit or loss;

(b) how additional consideration should be accounted for by the venturer; and

(c) how any unrealised gain or loss should be presented in the consolidated financial statements of the venturer.

4 This Interpretation deals with the venturer's accounting for non-monetary contributions to a JCE in exchange for an equity interest in the JCE that is accounted for using either the equity method or proportionate consolidation.

Conclusions

5 In applying HKAS 31.48 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit and loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:

(a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE; or

(b) the gain or loss on the non-monetary contribution cannot be measured reliably; or

(c) the contribution transaction lacks commercial substance, as that term is described in HKAS 16.

If exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit and loss unless paragraph 6 also applies.

6 If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit and loss.

7 Unrealised gains or losses on non-monetary assets contributed to JCEs shall be eliminated against the underlying assets under the proportionate consolidation method or against the investment under the equity method. Such unrealised gains or losses shall not be presented as deferred gains or losses in the venturer's consolidated ~~balance sheet~~statement of financial position.

Basis for Conclusions

HK(SIC)-Int 13 is based on SIC Interpretation 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. In approving HK(SIC)-Int 13, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 13. Accordingly, there are no significant differences between HK(SIC)-Int 13 and SIC Interpretation 13. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 13 referred to below generally correspond with those in HK(SIC)-Int 13.

8 IAS 31.48 requires that, while the assets are retained in the joint venture, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers. Additional losses are recognised if required by IAS 31.48.

9 IAS 31.48 refers to the transfer of the 'significant risks and rewards of ownership' as a condition for recognition of gains or losses resulting from transactions between venturers and joint ventures. IAS 18.16(a) to (d) contain examples of situations where the risks and rewards of ownership are typically not transferred. This guidance also applies by analogy to the recognition of gains or losses resulting from contributions of non-monetary assets to JCEs. Since the venturer participates in joint control of the JCE, it retains some 'continuing managerial involvement' in the asset transferred. However, this does not generally preclude the recognition of gains or losses since joint control does not constitute control to the degree usually associated with ownership (IAS 18.14(b)).

10 Paragraph 92 of the *Framework* states: 'income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably'. IAS 18.14(c) requires, among other conditions, that revenue from the sale of goods should be recognised when 'the amount of revenue can be measured reliably'. The requirement for reliable measurement also applies to the recognition of gains or losses resulting from a contribution of non-monetary assets to a JCE.

11 IAS 18.12 explains that 'when goods and services are exchanged or swapped for goods or services which are of similar nature and value, the exchange is not regarded as a transaction which generates revenue'. The same rationale applies to a contribution of non-monetary assets since a contribution to a JCE is, in substance, an exchange of assets with the other venturers at the level of the JCE.

12 To the extent that the venturer also receives cash or non-monetary assets dissimilar to the assets contributed in addition to equity interests in the JCE, the realisation of which is not dependent on the future cash flows of the JCE, the earnings process is complete. Accordingly, the appropriate portion of the gain on the non-monetary contribution is recognised in profit or loss for the period.

13 It is not appropriate to present unrealised gains or losses on non-monetary assets contributed to JCEs as deferred items since such items do not meet the recognition criteria for assets or liabilities as defined in the *Framework* (paragraphs 53 to 64 and paragraphs 89 to 91).

Date of issue

December 2004

Effective date

This Interpretation becomes effective for annual financial periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of HKAS 8.

14 The accounting for the non-monetary contribution transactions specified in paragraph 5 shall be applied prospectively to future transactions.

15 If an entity applies HKAS 16, *Property, Plant and Equipment* for an earlier period, it shall also apply this Interpretation for that earlier period.

15A This Interpretation supersedes paragraphs 39 to 41 of SSAP 21 *Accounting for Interests in Joint Ventures* (issued in May 2001).

HK(SIC)-Int 25
~~Issued December 2004~~Revised August 2010

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 25

Income Taxes — Changes in the Tax Status of an Entity or its Shareholders

Hong Kong Institute of
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香港會計師公會

Hong Kong (SIC) Interpretation 25
Income Taxes - Changes in the Tax Status of an Entity or its Shareholders

HK(SIC) Interpretation 25 *Income Taxes - Changes in the Tax Status of an Entity or its Shareholders* (HK(SIC)-Int 25) is set out in paragraph 4. HK(SIC)-Int 25 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards.*

References

- HKAS 1 *Presentation of Financial Statements (as revised in 2007)*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 12 *Income Taxes*

Issue

1 A change in the tax status of an entity or of its shareholders may have consequences for an entity by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an entity's equity instruments or upon the restructuring of an entity's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an entity may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.

2 A change in the tax status of an entity or its shareholders may have an immediate effect on the entity's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the entity, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the entity's assets and liabilities.

3 The issue is how an entity should account for the tax consequences of a change in its tax status or that of its shareholders.

Conclusions

4 A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised ~~directly in equity~~outside profit or loss. The current and deferred tax consequences of a change in tax status shall be included in net profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity or in amounts recognised in other comprehensive income. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in net profit or loss), shall be charged or credited directly to equity. Those tax consequences that relate to amounts recognised in other comprehensive income shall be recognised in other comprehensive income.

Basis for Conclusions

HK(SIC)-Int 25 is based on SIC Interpretation 25 *Income Taxes - Changes in the Tax Status of an Entity or its Shareholders*. In approving HK(SIC)-Int 25, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 25. Accordingly, there are no significant differences between HK(SIC)-Int 25 and SIC Interpretation 25. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 25 referred to below generally correspond with those in HK(SIC)-Int 25.

5 IAS 12.58 requires current and deferred tax to be included in ~~the net~~ profit or loss for the period, except to the extent the tax arises from a transaction or event that is recognised outside profit or loss either in other comprehensive income or directly in equity, in the same or a different period, (or arises from a business combination ~~that is an acquisition~~). IAS 12.61A requires ~~that~~ current and deferred tax to be recognised outside profit or loss ~~charged or credited directly to equity~~ if the tax relates to items that are recognised~~credited or charged~~, in the same or a different period, outside profit or loss~~directly to equity~~.

5A IAS 12.62 identifies examples of circumstances in which a transaction or event is recognised in other comprehensive income as permitted or required by another IFRS. All of these circumstances result in changes in the recognised amount of equity through recognition in other comprehensive income.

6 IAS 12.62A identifies examples of circumstances in which a transaction or event is recognised directly in equity as ~~is~~ permitted or required by another ~~Standard~~IFRS. All of these circumstances result in changes in the recognised amount of equity through recognition of a credit or charge directly to equity.

7 IAS 12.65 explains that where the tax base of a revalued asset changes, any tax consequence is recognised in other comprehensive income~~directly in equity~~ only to the extent that a related accounting revaluation was or is expected to be recognised in other comprehensive income~~directly in equity~~ (revaluation surplus).

8 Because tax consequences recognised outside profit or loss, whether in other comprehensive income or directly in equity, must relate to a transaction or event recognised outside profit or loss~~directly in equity~~ in the same or a different period, the cumulative amount of tax ~~charged or credited directly to equity~~ recognised outside profit or loss can be expected to be the same amount that would have been recognised outside profit or loss ~~charged or credited directly to equity~~ if the new tax status had applied previously. IAS 12.63(b) acknowledges that determining the tax consequences of a change in the tax rate or other tax rules that affects a deferred tax asset or liability and relates to an item previously recognised outside profit or loss ~~charged or credited to equity~~ may prove to be difficult. Because of this, IAS 12.63 suggests that an allocation may be necessary.

Date of issue

December 2004

Effective date

This Interpretation becomes effective for annual accounting periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies shall be accounted for in accordance with HKAS 8.

This Interpretation supersedes Interpretation 21 *Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders* (issued in July 2002).

HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 4. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

HK(SIC)-Int 29
~~Issued December 2004~~Revised August 2010

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 29

Service Concession Arrangements: Disclosures

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

Hong Kong (SIC) Interpretation 29
Service Concession Arrangements: Disclosures

HK(SIC) Interpretation 29 *Service Concession Arrangements: Disclosures* (HK(SIC)-Int 29) is set out in paragraphs 6 and 7. HK(SIC)-Int 29 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards.*

References

- HKAS 1 *Presentation of Financial Statements (as revised in 2007)*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 17 *Leases*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- HKAS 38 *Intangible Assets*
- HK(IFRIC)-Int 12 *Service Concession Arrangements*

Issue

1 An entity (the operator) may enter into an arrangement with another entity (the grantor) to provide services that give the public access to major economic and social facilities. The grantor may be a public or private sector entity, including a governmental body. Examples of service concession arrangements involve water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. Examples of arrangements that are not service concession arrangements include an entity outsourcing the operation of its internal services (eg employee cafeteria, building maintenance, and accounting or information technology functions).

2 A service concession arrangement generally involves the grantor conveying for the period of the concession to the operator:

(a) the right to provide services that give the public access to major economic and social facilities, and

(b) in some cases, the right to use specified tangible assets, intangible assets, or financial assets,

in exchange for the operator:

(c) committing to provide the services according to certain terms and conditions during the concession period, and

(d) when applicable, committing to return at the end of the concession period the rights received at the beginning of the concession period and/or acquired during the concession period.

3 The common characteristic of all service concession arrangements is that the operator both receives a right and incurs an obligation to provide public services.

4 The issue is what information should be disclosed in the notes in the financial statements of an operator and a grantor.

5 Certain aspects and disclosures relating to some service concession arrangements are already addressed by existing Hong Kong Financial Reporting Standards (eg HKAS 16, applies to acquisitions of items of property, plant and equipment, HKAS 17 applies to leases of assets, and HKAS 38 applies to acquisitions of intangible assets). However, a service concession arrangement may involve executory contracts that are not addressed in Hong Kong Financial Reporting Standards, unless the contracts are onerous, in which case HKAS 37 applies.

Therefore, this Interpretation addresses additional disclosures of service concession arrangements.

Conclusions

6 All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. An operator and a grantor shall disclose the following in each period:

(a) a description of the arrangement;

(b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);

(c) the nature and extent (eg quantity, time period or amount as appropriate) of:

(i) rights to use specified assets;

(ii) obligations to provide or rights to expect provision of services;

(iii) obligations to acquire or build items of property, plant and equipment;

(iv) obligations to deliver or rights to receive specified assets at the end of the concession period;

(v) renewal and termination options; and

(vi) other rights and obligations (eg major overhauls);

(d) changes in the arrangement occurring during the period; and

(e) how the service arrangement has been classified.

6A An operator shall disclose the amount of revenue and profits or losses recognised in the period on exchanging construction services for a financial asset or an intangible asset.

7 The disclosures required in accordance with paragraph 6 of this Interpretation shall be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (eg toll collections, telecommunications and water treatment services).

Basis for Conclusions

HK(SIC)-Int 29 is based on SIC Interpretation 29 *Service Concession Arrangements: Disclosures*. In approving HK(SIC)-Int 29, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 29. Accordingly, there are no significant differences between HK(SIC)-Int 29 and SIC Interpretation 29. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 29 referred to below generally correspond with those in HK(SIC)-Int 29.

8 Paragraph 15 of the *Framework* states that the economic decisions taken by users of financial statements require an evaluation of the ability of the entity to generate cash and cash equivalents and of the timing and certainty of their generation. Paragraph 21 of the *Framework* states that financial statements also contain notes and supplementary schedules and other information. For example, they may contain additional information that is relevant to the needs of users about the items in the ~~balance sheet~~statement of financial position and statement of comprehensive income~~ statement~~. They may also include disclosures about the risks and uncertainties affecting the entity and any resources and obligations not recognised in the ~~balance sheet~~statement of financial position.

9 A service concession arrangement often has provisions or significant features that warrant disclosure of information necessary to assist in assessing the amount, timing and certainty of future cash flows, and the nature and extent of the various rights and obligations involved. The rights and obligations associated with the services to be provided usually involve a high level of public involvement (eg to provide electricity to a city). Other obligations could include significant acts such as building an infrastructure asset (eg power plant) and delivering that asset to the grantor at the end of the concession period.

10 IAS 1.112(c)~~103(c)~~ requires an entity's notes to provide additional information that is not presented elsewhere in the financial statements~~on the face of the balance sheet, income statement, statement of changes in equity or cash flow statement~~, but is relevant to an understanding of any of them. The definition of notes in IAS 1.7~~11~~ indicates that notes provide narrative descriptions or disaggregations of items disclosed in the ~~balance sheet~~statement of financial position, statement of comprehensive income, separate income statement (if presented), statement of changes in equity and statement of cash flows~~s statement~~, as well as information about items that do not qualify for recognition in those statements.

Date of issue

December 2004

Effective date

This Interpretation becomes effective for annual accounting periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies shall be accounted for in accordance with HKAS 8.

An entity shall apply the amendment in paragraphs 6(e) and 6A for annual periods beginning on or after 1 January 2008. If an entity applies HK(IFRIC)-Int 12 for an earlier period, the amendment shall be applied for that earlier period.

This Interpretation supersedes Interpretation 16 *Disclosure - Service Concession Arrangements* (issued in July 2002).