SME-FRF & SME-FRS
~~Issued August 2005~~Revised February 2011

~~Effective for a Qualifying Entity's financial statements that cover a period beginning on or after 1 January 2005~~
Effective for a Qualifying Entity's financial statements that cover a period beginning on or before 2 March 2014

Small and Medium-sized Entity Financial Reporting Framework and

Financial Reporting Standard

This standard is to be replaced by SME-FRF & SME-FRF (Revised), effective for a qualifying entity's financial statements which cover a period beginning on or after 3 March 2014.

Early application of SME-FRF & SME-FRF (Revised) is not permitted.

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

Contents

The *Small and Medium-sized Entity Financial Reporting Framework* (SME-FRF) and *Financial Reporting Standard* (SME-FRS) are standards of accounting practices issued by the Council of the Hong Kong Institute of Certified Public Accountants pursuant to section 18A of the Professional Accountants Ordinance.

SME-FRF and SME-FRS should be read in the context of the *Preface to Hong Kong Financial Reporting Standards*. SME-FRS should also be read in the context of the SME-FRF.

SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING FRAMEWORK

Scope

1. The Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) sets out the conceptual basis (paragraphs 2-15) and qualifying criteria (paragraphs 16-26) for the preparation of financial statements in accordance with the Small and Medium-sized Entity Financial Reporting Standard (SME-FRS).

Users

2. Users of financial statements generally include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and, in some cases, the public. For SMEs, the most significant users are likely to be owners, government and creditors, who may have the power to obtain information additional to that contained in the financial statements. Management is also interested in the information contained in the financial statements, even though it has access to additional management and financial information.

Objective

3. The objective of financial statements is to provide information about the financial position and performance of an entity that is useful to users of such information. Financial statements show the results of management's stewardship of and accountability for the resources entrusted to it.

Underlying Assumptions

4. Financial statements are prepared on the accrual basis of accounting. They are normally prepared on the assumption that an entity is a going concern and will continue to operate for at least the foreseeable future.

Qualitative Characteristics

5. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal characteristics are:

   (a) Understandability: It is essential that information provided in financial statements is readily understandable by users.

   (b) Relevance: To be useful, information must be relevant to the needs of users. The relevance of information is affected by its nature and materiality.

   (c) Reliability: Information is reliable when it is free from material error and bias and can be depended on by users to represent faithfully that which it is said to represent. In assessing reliability, substance over form, prudence, neutrality and completeness are also considered.

   (d) Comparability: Users must be able to compare the financial statements of an entity over time in order to identify trends in the entity's financial position and performance.

6. Constraints: The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Users of financial statements should be aware of this constraint.

7. In practice, trade-offs between qualitative characteristics are often necessary. Determining the relative importance of the characteristics in different cases is a matter of professional judgment.

Elements

8. An “asset” is 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.

9. A “liability” is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

10. “Equity” is the residual interest in the assets of the entity after all its liabilities have been deducted.

11. “Income” encompasses both revenue and gains. It includes increases in economic benefits during the accounting period in the form of inflows or enhancements of assets as well as decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

12. “Expenses” encompass losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses are decreases in economic benefits.

Recognition

13. An item that meets the definition of an element should be recognised if (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.

Measurement

14. The measurement base most commonly adopted by entities in preparing their financial statements is historical cost. This may be combined with other measurement bases for certain specific items, as referred to in the SME-FRS (for example, Section 15 *The Effects of Changes in Foreign Exchange Rates*).

15. Under the historical cost convention:

    (a) assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition; and

    (b) liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

    Assets should not be revalued nor should future cash flows be discounted in the measurement of assets and liabilities except when required or permitted by the SME-FRS.

Qualifying Entities

16. A company incorporated under the Companies Ordinance qualifies for reporting under the SME-FRF if it satisfies the criteria set out in section 141D of that Ordinance. Compliance with the SME-FRF and SME-FRS is necessary in order for financial statements to give a "true and correct view" when a Hong Kong incorporated company prepares its financial statements in accordance with section 141D of the Companies Ordinance.

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

    (a) all of its owners agree to prepare the financial statements in accordance with the SME-FRS; and

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

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

19. Unless the law requires otherwise, it is presumed that, once an agreement is made by all owners to prepare the financial statements in accordance with the SME-FRS, the agreement will remain valid until there is a change in the ownership or the agreement is revoked by an owner or an entity no longer qualifies for reporting under the SME-FRF.

20. When an entity has not been considered to be an SME in terms of its size under paragraph 24 and subsequently becomes an SME, the entity will not qualify for reporting under the SME-FRF in terms of paragraph 17(b) until the entity has been determined to be an SME for two consecutive reporting periods.

21. Where an entity has previously qualified for reporting under the SME-FRF in terms of paragraph 17, the entity will no longer qualify for reporting under the SME-FRF in terms of paragraph 17(b) until the entity is no longer an SME for two consecutive reporting periods.

Public Accountability

22. An entity has public accountability for the purposes of the SME-FRF if:

    (a) at any time during the current or preceding reporting period, the entity (whether in the public or private sector) is an issuer of securities, that is, its equity or debt securities are publicly traded or it is in the process of issuing publicly traded equity or debt securities;

    (b) the entity is an institution authorised under the Banking Ordinance;

    (c) the entity is an insurer authorised under the Insurance Companies Ordinance; or

    (d) the entity is a corporation which is granted a licence under the Securities and Futures Ordinance to carry on business in a regulated activity in Hong Kong.

23. An entity does not have public accountability, for the purposes of the SME-FRF, solely by reason of receiving public funds from another entity that has the power to tax, rate or levy to obtain public funds.

Size

24. An entity is considered to be an SME if it does not exceed any two of the following:

(a) Total annual revenue of HK$50 million.

(b) Total assets of HK$50 million at the balance sheet date.

(c) 50 employees.

25. For the purposes of paragraph 24, the total revenue and total assets are determined after the application of the SME-FRS and, in the case where the reporting period is shorter or longer than a year, the total revenue is determined on an annualised basis.

26. For the purposes of paragraph 24, the number of employees is the average number of persons employed by the entity during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows:

(a) Determine the number of employees as at the end of each calendar month.

(b) Add together all the monthly numbers in (a).

(c) Divide the number in (b) by the number of months in the reporting period.

Transitional Provisions

27. The transition to the SME-FRF and SME-FRS is accounted for as follows:

(a) All items recognised previously under a different GAAP (for example, deferred tax liability) which do not meet the recognition criteria under the SME-FRF and SME-FRS are to be derecognised and dealt with as a change of accounting policy under the SME-FRS.

(b) All items not recognised previously under a different GAAP which do meet the recognition criteria under the SME-FRF and SME-FRS are to be recognised in accordance with the relevant section of the SME-FRS and dealt with as a change of accounting policy under the SME-FRS.

(c) All items recognised previously under a different GAAP, which do meet the recognition criteria under the SME-FRF and SME-FRS, but which were previously measured on a basis inconsistent with the SME-FRF and SME-FRS are to be re-measured in accordance with the relevant section of the SME-FRS and dealt with as a change of accounting policy under the SME-FRS.

Effective Date

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

SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING STANDARD

Definitions

The following terms are used in the SME-FRS with the meanings specified:

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

An ***active market*** is a market in which all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

An ***asset*** is a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

An ***associate*** is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

Borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds.

Carrying amount is the amount at which an asset or a liability is recognised in the balance sheet after the deduction of (if applicable) any accumulated depreciation (amortisation) and accumulated impairment losses thereon, or any write-down to net realisable value.

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity. They may include:

(a) the individual's spouse and children;

(b) children of the individual's spouse; and

(c) dependants of the individual or the individual's spouse.

The ***closing rate*** is the spot exchange rate at the balance sheet date.

A ***construction contract*** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use. Construction contracts include: contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

A ***constructive obligation*** is an obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A ***contingent asset*** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A ***contingent liability*** is:

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

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

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

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

Contingent rent is that portion of the lease payments which is not fixed in amount but is based on a factor other than the passage of time (e.g. percentage of sales, amount of usage, price indices, market rates of interest).

Control (of an asset) is the power to obtain the future economic benefits that flow from the asset.

Control (of an entity) is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition, production or construction.

A ***cost-plus contract*** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Depreciable amount is the cost of an asset less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Economic life is either:

(a) the period over which an asset is expected to be economically usable by one or more users; or

(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Events after the balance sheet date are events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue. Two types of events can be identified:

(a) those providing evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date); and

(b) those indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date).

Exchange difference is the difference resulting from translating a given number of units of one currency to another currency at different exchange rates.

Exchange rate is the ratio of exchange for two currencies.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

A ***finance lease*** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

A ***fixed price contract*** is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

Foreign currency is a currency other than the reporting currency of an entity.

Government refers to government, government agencies and similar bodies, whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

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 on them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

Guaranteed residual value is:

(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and

(b) in the case of the lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging the obligations under the guarantee.

Historical cost is:

(a) in the case of assets, the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition; and

(b) in the case of liabilities, the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Historical cost convention is the measurement basis whereby:

(a) assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition; and

(b) liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business; and whereby:

assets should not be revalued nor should future cash flows be discounted in the measurement of assets and liabilities except when required or permitted by the SME-FRS.

An ***impairment loss*** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

The ***inception of the lease*** is the earlier of the date of the lease agreement or the date of commitment by the parties to the principal provisions of the lease.

The lessee's ***incremental borrowing rate of interest*** is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

An ***intangible asset*** is an identifiable non-monetary asset without physical substance.

The ***interest rate implicit in the lease*** is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments; and

(b) the unguaranteed residual value

to be equal to the fair value of the leased asset.

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Investment (in a security) is a financial asset (such as a bond or share or other negotiable instrument evidencing debt or ownership) held by an entity for trading, the accretion of wealth through distribution (such as interest and dividends), for capital appreciation or for other benefits to the investing entity such as those obtained through trading relationships. Current investments are those that would satisfy the criteria for being classified as current in accordance with paragraph 1.16 of the SME-FRS.

Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

A ***joint venture*** is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

A ***lease*** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The ***lease term*** is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

A ***legal obligation*** is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

A ***liability*** is a present obligation of an entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Minimum lease payments are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with, in the case of the lessee, any amounts guaranteed by the lessee or by a party related to the lessee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable, and if, at the inception of the lease, it is reasonably certain that the option will be exercised, then the minimum lease payments comprise the minimum payments payable over the lease term and the payment required to exercise this purchase option.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

A ***non-cancellable lease*** is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency;

(b) with the permission of the lessor;

(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

An ***obligating event*** is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

An ***onerous contract*** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

An ***operating lease*** is a lease other than a finance lease.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Property, plant and equipment are tangible assets that:

(a) are held by an entity for use in the production or supply of goods or services, for rental to others, for investment potential, or for administrative purposes; and

(b) are expected to be used during more than one period.

A ***provision*** is a liability of uncertain timing or amount.

A ***qualifying asset*** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Recoverable amount is the greater of an asset's net selling price and future net cash flow expected from the continued use of that asset.

Related party: A party is related to an entity if:

(a) directly, or indirectly through one or more intermediaries, the party:

  (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);

  (ii) has an interest in the entity that gives it significant influence over the entity; or

  (iii) has joint control over the entity;

(b) the party is an associate of the entity;

(c) the party is a joint venture in which the entity is a venturer;

(d) the party is a member of the key management personnel of the entity or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

A ***related party transaction*** is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Residual value is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Significant influence is the power to participate in the financial and operating policy decisions of an entity, but is not control or joint control over those policies.

A ***subsidiary*** is an entity that is controlled by another entity.

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, on which income taxes are payable (recoverable).

Useful life is:

(a) the period of time over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

Section 1
Presentation of Financial Statements

Components of financial statements

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

(a) a balance sheet;

(b) an income statement; and

(c) accounting policies and explanatory notes.

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

Overall considerations

1.2 Financial statements should properly present the financial position and financial performance of an entity. For an entity that qualifies for reporting under the SME-FRF, the appropriate application of the SME-FRS, with additional disclosure when necessary, would result in financial statements that achieve a proper presentation appropriate for SMEs. In the event that the SME-FRS does not cover an event or a transaction undertaken by an entity, management may consider the SME-FRF for guidance on developing an appropriate accounting policy, consistent with the historical cost convention, for that particular event or transaction.

1.3 An entity whose financial statements comply with the SME-FRS should disclose that fact. Such financial statements should not be described as complying with Hong Kong Financial Reporting Standards (HKFRS).

1.4 Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material.

1.5 In the extremely rare circumstances when management concludes that compliance with a requirement in the SME-FRS would be misleading, and that therefore departure from a requirement is necessary in order to achieve a proper presentation, in accordance with the SME-FRS, an entity should disclose:

(a) that management has concluded that the financial statements properly present the entity’s financial position and financial performance;

(b) that it has complied in all material respects with applicable sections of the SME-FRS, except for departing from them in order to achieve a proper presentation; and

(c) the nature and financial effect (when quantifiable) of the departure, including the treatment that the SME-FRS would require, the reason why that treatment would be misleading in the circumstances and the treatment adopted.

In the event of a departure, management should only adopt an accounting policy that is consistent with the historical cost convention.

1.6 When preparing financial statements, management should make an assessment of an entity’s ability to continue as a going concern. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not considered to be a going concern.

1.7 An entity should prepare its financial statements under the accrual basis of accounting.

1.8 The presentation and classification of items in the financial statements should be retained from one period to the next unless:

(a) a significant change in the nature of the operations of the entity or a review of its financial statement presentation demonstrates that the change will result in a more appropriate presentation of events or transactions; or

(b) a change in presentation is required by the SME-FRS.

1.9 Each material item should be presented separately in the financial statements. Immaterial amounts may be aggregated with amounts of a similar nature or function and need not be presented separately. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item judged in the particular circumstances where its presentation comes into question.

1.10 Assets and liabilities should not normally be offset in the financial statements. However, some offsetting is required or permitted in exceptional circumstances, as mandated by the SME-FRS. Offsetting may also take place where gains, losses and related expenses arising from the same or similar transactions are not material.

1.11 Unless the law requires otherwise or the SME-FRS permits or requires otherwise, comparative information with respect to the previous period should be disclosed for all numerical information in the financial statements. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Structure and content

1.12 Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed, and repeated when it is necessary for a proper understanding of the information presented:

(a) the name of the reporting entity or other means of identification;

(b) the balance sheet date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements; and

(c) the reporting currency.

1.13 Financial statements should be presented at least annually. When, in exceptional circumstances, an entity's balance sheet date changes and annual financial statements are presented for a period longer or shorter than one year, an entity should disclose, in addition to the period covered by the financial statements:

(a) the reason why a period other than one year is being used; and

(b) the fact that comparative amounts for the income statement and related notes are not comparable.

Balance sheet

1.14 An entity should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet. Paragraphs 1.16 to 1.20 of this Section apply when this distinction is made.

1.15 When an entity chooses not to make the classification in paragraph 1.14, assets and liabilities should be presented broadly in order of their liquidity and the entity should disclose, for each asset and liability item that combines amounts expected to be recovered or settled both before and after 12 months from the balance sheet date, the amount expected to be recovered or settled after more than 12 months.

1.16 An asset should be classified as current when it satisfies any of the following criteria:

(a) it is expected to be realised in, or is intended for sale or consumption in, the entity's normal operating cycle;

(b) it is held primarily for the purpose of being traded;

(c) it is expected to be realised within 12 months after the balance sheet date; or

(d) it is cash or a cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the balance sheet date.

All other assets should be classified as non-current.

1.17 A liability should be classified as current when it satisfies any of the following criteria:

(a) it is expected to be settled in the entity's normal operating cycle;

(b) it is held primarily for the purpose of being traded;

(c) it is due to be settled within 12 months after the balance sheet date; or

(d) the entity does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.[1]

All other liabilities should be classified as non-current.

1.18 An entity classifies its financial liabilities as current when they are due to be settled within 12 months after the balance sheet date, even if:

(a) the original term was for a period longer than 12 months; and

(b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue.

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[1] The classification of a term loan as a current or non-current liability in accordance with paragraph 1.17(d) should be determined by reference to the rights and obligations of the lender and the borrower, as contractually agreed between the two parties and in force as of the balance sheet date. In this regard, the probability of the lender choosing to exercise its right within the next twelve months after the balance sheet date is not relevant.

The classification of a term loan in accordance with the paragraph 1.17(d) should depend on whether or not the borrower has an unconditional right to defer payment for at least twelve months after the balance sheet date. Consequently, amounts repayable under a loan agreement which includes a clause that gives the lender the unconditional right to call the loan at any time should be classified by the borrower as current in its statement of financial position. This is because the borrower under such an agreement does not have an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date.

A more detailed discussion can be found in Hong Kong Interpretation 5 to the Hong Kong Financial Reporting Standards "Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause".

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

(a) property, plant and equipment;

(b) intangible assets;

(c) financial assets (including investments but excluding amounts shown under (e) and (g));

(d) inventories;

(e) trade and other receivables;

(f) tax assets;

(g) cash and cash equivalents;

(h) trade and other payables;

(i) tax liabilities;

(j) provisions;

(k) non-current liabilities;

(l) issued capital; and

(m) reserves.

1.20 Additional line items, headings and subtotals should be presented on the face of the balance sheet when such presentation is necessary to present properly the entity's financial position.

1.21 An entity should disclose the following, either on the face of the balance sheet or in the notes:

(a) for each class of share capital:

(i) the number of shares authorised;

(ii) the number of shares issued and fully paid, and issued but not fully paid;

(iii) par value per share, or that the shares have no par value;

(iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;

(v) the rights, preferences and restrictions attaching to that class, including restrictions on the distribution of dividends and the repayment of capital;

(vi) shares in the entity held by the entity itself; and

(vii) shares reserved for issuance under options and sales contracts, including the terms and amounts;

(b) where it is not otherwise self-evident, a description of the nature and purpose of each component within equity;

(c) the amount of dividends that were proposed or declared after the balance sheet date but before the financial statements were authorised for issue; and

(d) the amount of any cumulative preference dividends not recognised.

An entity without share capital, such as a partnership, should disclose information equivalent to that required above, showing movements during the period in each category of equity interest and the rights, preferences and restrictions attaching to each category of equity interest.

Income statement

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

(a) revenue;

(b) finance costs;

(c) tax expense; and

(d) profit or loss for the period.

Additional line items, headings and subtotals should be presented on the face of the income statement when such presentation is necessary to present properly the entity's financial performance.

1.23 All items of income and expense recognised in a period should be included in the determination of the profit or loss for the period unless the SME-FRS requires or permits otherwise.

1.24 When items of income and expense within profit or loss are of such size, nature or incidence that their disclosure is relevant to explain the performance of the entity for the period, the nature and amount of such items should be disclosed separately.

1.25 Circumstances that may give rise to the separate disclosure of items of income and expense in accordance with paragraph 1.24 include the following:

(a) the write-down of inventories to net realisable value or property, plant and equipment to recoverable amount, as well as the reversal of such write-downs;

(b) the write-down of intangible assets to recoverable amount, as well as the reversal of such write-downs;

(c) a restructuring of the activities of an entity and the reversal of any provisions for the costs of restructuring;

(d) disposals of items of property, plant and equipment;

(e) disposals of intangible assets;

(f) disposals of long-term investments;

(g) litigation settlements; and

(h) other reversals of provisions.

1.26 An entity should present, either on the face of the income statement or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity.

1.27 Entities classifying expenses by function should disclose additional information on the nature of expenses, including depreciation and amortisation expense and staff costs.

1.28 An entity should disclose, either on the face of the income statement or in the notes, the amount of dividends per share, declared or proposed, for the period covered by the financial statements.

Changes in equity

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

(a) the profit or loss for the period;

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

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

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

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

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

Accounting policies and explanatory notes

1.30 The notes to the financial statements should:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and events;

(b) disclose the information required by the SME-FRS that is not presented elsewhere in the financial statements; and

(c) provide additional information that is necessary for a proper presentation.

1.31 Notes to the financial statements should be presented in a systematic manner. Each item on the face of the balance sheet and the income statement should be cross-referenced to any related information in the notes.

1.32 The accounting policies section of the notes to the financial statements should describe:

(a) whether the financial statements have been prepared in accordance with the SME-FRS and the criteria on which the entity qualifies to apply the SME-FRS;

(b) the measurement basis (or bases) used in preparing the financial statements; and

(c) each specific accounting policy that is necessary for a proper understanding of the financial statements.

1.33 An entity should disclose the following, if the information is not disclosed elsewhere in information published with the financial statements:

(a) the domicile and legal form of the entity, its place of incorporation and the address of the registered office (or principal place of business, if different from the registered office); and

(b) a description of the nature of the entity's operations and its principal activities.

Section 2
Accounting Policies, Changes in Accounting Estimates and Errors

2.1 Management should use its judgment in developing an accounting policy resulting in information that is relevant to the needs of users of the financial statements and is reliable in nature. Management should select and apply an entity's accounting policies so that the financial statements comply with all the requirements of the SME-FRS and are consistent with the historical cost convention.

2.2 An entity should select and apply its accounting policies for a period consistently for similar transactions, other events and circumstances, unless the SME-FRS specifically requires or permits categorisation of items for which different policies may be appropriate.

Changes in accounting policies

2.3 A change in accounting policy should be made only if it is required by the SME-FRS or if it results in a more relevant and reliable presentation in the financial statements of the effects of transactions or other events on the entity's financial position or financial performance.

2.4 The following are not changes in accounting policies:

(a) the adoption of an accounting policy for transactions or other events that differ in substance from those previously occurring; or

(b) the adoption of a new accounting policy for transactions or other events that did not occur previously or were immaterial.

2.5 A change in an accounting policy that is made following an amendment to the SME-FRS should be accounted for in accordance with the transitional provisions, if any, issued with the amendment to the SME-FRS.

2.6 Where application of a change in the SME-FRS has a material effect on the current period or any prior period presented, an entity should disclose the following:

(a) the fact that the change in accounting policy is made in accordance with the change in the SME-FRS, with a description of those provisions;

(b) the amount of the adjustment for the current period and for each prior period presented;

(c) the amount of the adjustment relating to periods prior to those included in the comparative information; and

(d) the fact that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort or because this is in accordance with the transitional provisions issued with the amendment to the SME-FRS.

2.7 A change in an accounting policy other than the one mandated under paragraph 2.5 should be applied retrospectively. The opening balance of reserves for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented should be adjusted, where applicable, as if the new accounting policy had always been in use.

2.8 Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restated, the new accounting policy should be applied to the balances of assets and liabilities as at the beginning of the next period, and a corresponding adjustment should be made to the opening balance of reserves for the next period.

2.9 When a change in an accounting policy has an effect on the current period or any prior period presented, or may have an affect in subsequent periods, an entity should disclose the following:

(a) the reasons for the change;

(b) the amount of the adjustment for the current period and for each prior period presented;

(c) the amount of the adjustment relating to periods prior to those presented; and

(d) that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.

Changes in accounting estimates

2.10 The effect of a change in an accounting estimate should be recognised prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

2.11 The nature and amount of a change in an accounting estimate that has an effect on the current period or is expected to have an effect in subsequent periods should be disclosed. If it would require undue cost or effort to quantify that amount, this fact should be disclosed.

Errors

2.12 The amount of the correction of a material prior period error should be accounted for retrospectively. A prior period error should be corrected by:

(a) either restating the comparative amounts for the prior periods in which the error occurred; or

(b) when the error occurred before the earliest prior period presented, restating the opening balance of reserves for that period, so that the financial statements are presented as if the error had never occurred.

All errors other than prior period errors should be corrected in the current period.

2.13 Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When no restatement of comparative figures takes place, the opening balance of reserves for the next period should be restated for the cumulative effect of the error before the beginning of that period.

2.14 An entity should disclose:

(a) the nature of the prior period error; and

(b) the amount of the correction for each prior period presented.

Section 3
Property, Plant and Equipment

3.1 An item of property, plant and equipment (including property held for rental and/or for investment potential) should be recognised as an asset when:

(a) it is probable that future economic benefits associated with the asset will flow to the entity; and

(b) the cost of the asset to the entity can be measured reliably.

3.2 An item of property, plant and equipment that qualifies for recognition as an asset should initially be measured at its cost.

3.3 The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs include the following:

(a) the cost of site preparation;

(b) initial delivery and handling costs;

(c) installation costs;

(d) professional fees such as for architects, engineers and lawyers; and

(e) the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision under Section 10.

3.4 Administration and other general overhead costs are not a component of the cost of property, plant and equipment unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start-up and similar pre-production costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition. Initial operating losses incurred prior to an asset’s achieving planned performance are recognised as an expense.

3.5 The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

3.6 An item of property, plant and equipment may be acquired in exchange or part exchange for a dissimilar item of property, plant and equipment or other asset. The cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up adjusted by the amount of any cash or cash equivalents transferred.

3.7 Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised should be added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the entity. All other subsequent expenditure should be recognised as an expense in the period in which it is incurred.

3.8 Expenditure on repairs or maintenance of property, plant and equipment is made to restore or maintain the future economic benefits that an entity can expect from the originally assessed standard of performance of the asset. As such, it is usually recognised as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.

3.9 Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph 3.1 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the replaced asset is written off.

Measurement subsequent to initial recognition

3.10 Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Depreciation and impairment

3.11 The depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life. The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity. The depreciation charge for each period should be recognised as an expense unless it is included in the carrying amount of another asset.

3.12 The economic benefits embodied in an item of property, plant and equipment are consumed by the entity principally through the use of the asset. However, other factors such as technical obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits that might have been expected to be available from the asset. Consequently, all the following factors need to be considered in determining the useful life of an asset:

(a) the expected usage of the asset by the entity (usage is assessed by reference to the asset's expected capacity or physical output);

(b) the expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used, the repair and maintenance programme of the entity, and the care and maintenance of the asset while idle;

(c) technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or the service output of the asset; and

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

3.13 Land and buildings are separable assets and are dealt with separately for accounting purposes, even when they are acquired together. Freehold land normally has an unlimited life and, therefore, is not depreciated. Leasehold interest in land from the Government of the Hong Kong Special Administrative Region or elsewhere with similar features are accounted for as property, plant and equipment in accordance with this Section. Leasehold land is to be depreciated over the lease term. Buildings have a limited life and, therefore, are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the useful life of the building.

3.14 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used for an asset is selected based on the expected pattern of economic benefits from that asset and is consistently applied from period to period unless there is a change in the expected pattern of economic benefits from that asset.

3.15 The useful life of an item of property, plant and equipment should be reviewed annually and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods should be adjusted.

3.16 The depreciation method applied to property, plant and equipment should be reviewed annually and, if there has been a significant change in the expected pattern of economic benefits from those assets, the method should be changed to reflect the changed pattern. When such a change in depreciation method is necessary, the change should be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.

3.17 To determine whether an item of property, plant and equipment is impaired, an entity applies Section 9 *Impairment of Assets.* That Section explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

Retirements and disposals

3.18 An item of property, plant and equipment should be eliminated from the balance sheet on disposal or when the asset is permanently withdrawn from use and no future economic benefits are expected from its disposal.

3.19 Gains or losses arising from the retirement or disposal of an item of property, plant and equipment should be determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.

Disclosure

3.20 An entity should disclose, for each class of property, plant and equipment:

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

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

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

(i) additions;

(ii) disposals;

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

(iv) impairment losses reversed in the income statement during the period (if any);

(v) depreciation; and

(vi) other movements.

Comparative information is not required.

3.21 An entity should also disclose the existence and amounts of restrictions on title, as well as property, plant and equipment pledged as security separately for:

(a) the entity's liabilities; and

(b) another entity's liabilities.

Section 4
Intangible Assets

Control of an asset

4.1 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an entity may be able to control the future economic benefits in some other way.

Recognition and initial measurement

4.2 An intangible asset should be recognised if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

4.3 An entity should assess the probability of future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

4.4 An intangible asset should be measured initially at cost.

4.5 Internally generated goodwill should not be recognised as an asset.

4.6 *Research phase*
No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

4.7 *Development phase*
An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) the entity's intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits (among other things, the entity should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset);

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

4.8 Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

Recognition of an expense

4.9 Expenditure on an intangible item should be recognised as an expense when it is incurred, unless it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 4.2 to 4.8).

4.10 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 4.6). Examples of other expenditure that is recognised as an expense when it is incurred include:

(a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment under Section 3. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an entity.

4.11 Expenditure on an intangible item that was initially recognised as an expense in previous financial statements should not be recognised as part of the cost of an intangible asset at a later date.

4.12 Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:

(a) it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) this expenditure can be reliably measured and attributed to the asset.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

4.13 After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation

4.14 *Amortisation period*
The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

4.15 If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

4.16 *Amortisation method*
The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another section of this SME-FRS permits or requires it to be included in the carrying amount of another asset.

4.17 *Residual value*
The residual value of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market for the asset and:

 (i) its residual value can be determined by reference to that market; and

 (ii) it is probable that such a market will exist at the end of the asset's useful life.

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

4.19 To determine whether an intangible asset is impaired, an entity applies Section 9 *Impairment of Assets.* That Section explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

4.20 An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

4.21 Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.

Disclosure

4.22 An entity should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) the useful lives or the amortisation rates used;

(b) the amortisation methods used;

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

(d) the line item(s) of the income statement in which the amortisation of intangible assets is included; and

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

 (i) additions;

 (ii) retirements and disposals;

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

 (iv) impairment losses reversed in the income statement during the period (if any);

 (v) amortisation recognised during the period; and

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

Comparative information is not required.

4.23 An entity should also disclose:

(a) if an intangible asset is amortised over more than 20 years, the reasons why the presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use is rebutted;

(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the entity as a whole; and

(c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security separately for:

(i) the entity's liabilities; and

(ii) another entity's liabilities.

Section 5
Leases

Classification of leases

5.1 The classification of leases is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibility of losses from idle capacity or technological obsolescence and of variations in return caused by changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.

5.2 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Following are examples of situations that would normally lead to a lease being classified as a finance lease:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset, even if title is not transferred;

(d) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased assets are of a specialised nature such that only the lessee can use them without major modifications.

5.3 Following are indicators of situations that, individually or in combination, could also lead to a lease being classified as a finance lease:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee has the ability to continue the lease for a secondary period at a rent substantially lower than market rent.

Finance leases

5.4 Lessees should recognise finance leases as assets and liabilities in their balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments, the discount factor is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

5.5 Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated on a systematic basis to periods during the lease term either by way of the straight-line method, the sum-of-digits methods or a method that produces a constant periodic rate of interest on the remaining balance of the liability for each period.

5.6 A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for leased assets should be consistent with that for depreciable assets that are owned.

5.7 If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

5.8 *Disclosure*
Lessees should disclose for finance lease at the balance sheet date the carrying amount of the asset, and the outstanding liability falling due in each of the following periods:

(a) not later than one year; and

(b) later than one year.

Operating leases

5.9 Lease payments under an operating lease should be recognised as an expense in the income statement on a straight-line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit.

5.10 All incentives for the agreement of a new or renewed operating lease should be recognised as an integral part of the net consideration agreed for the use of the leased asset. Lessees should recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term.

5.11 *Disclosure*
Lessees should disclose the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(a) not later than one year; and

(b) later than one year.

Sale and leaseback

5.12 A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payment and the sale price are usually interdependent since they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease involved.

5.13 If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount should not be immediately recognised as income in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term.

5.14 If a sale and leaseback transaction results in an operating lease and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

5.15 For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

Section 6
Investments

6.1 This Section should be applied in accounting for investments in subsidiaries, associates, joint ventures and other investments in securities. This Section should not be applied in accounting for properties held for rental and/or for investment potential as they are dealt with in Section 3 *Property, Plant and Equipment*.

6.2 An investment should be recognised as an asset when:

(a) it is probable that future economic benefits associated with the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

6.3 An investment that qualifies for recognition as an asset should initially be measured at its cost.

6.4 The cost of an investment includes acquisition charges such as brokerages, fees, duties and taxes.

6.5 If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued and not their nominal or par value. If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. In cases where the fair value of the securities issued or the asset given up is not reliably determinable, the acquisition cost should be the fair value of the investment acquired.

6.6 Interest and dividends receivable in connection with an investment are generally regarded as income, being the return on the investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. For example, when unpaid interest has accrued before the acquisition of an interest-bearing investment and is therefore included in the price paid for the investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion is deducted from cost. When dividends on equity securities are declared from pre-acquisition profits a similar treatment applies. If it is difficult to make such an allocation except on an arbitrary basis, the cost of an investment is normally reduced by dividends receivable only if they clearly represent a recovery of part of cost.

Measurement subsequent to initial recognition

6.7 Except as provided in paragraph 6.8 for held-to-maturity securities, subsequent to initial recognition as an asset, an investment should be carried at:

(a) the lower of cost and net realisable value for current investments; and

(b) cost less accumulated impairment losses for long-term investments.

Changes in the carrying amount of an investment from one balance sheet date to another should be recognised as income or expense in the income statement.

6.8 The difference between the acquisition cost and redemption value of an investment in held-to-maturity debt securities (the discount or premium on acquisition) should be amortised by the entity on a systematic basis over the period from acquisition to maturity either by way of the straight-line method, or a method whereby a constant yield is earned on the investment. The amortised discount or premium is credited or charged to income as though it were interest and added to or subtracted from the carrying amount of the security. The resulting carrying amount is then regarded as cost.

Disposals of investments

6.9 Gains or losses arising from the disposal of an investment should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.

6.10 When disposing of part of an entity's holding of a particular investment, a carrying amount must be allocated to the part sold. This carrying amount is usually determined from the average carrying amount of the total holding of the investment.

Disclosure

6.11 An entity should disclose:

(a) the measurement bases used for determining the carrying amount of investments;

(b) the significant amounts included in income for:

(i) interest and dividends;

(ii) profits and losses on disposal of investments;

(iii) impairment losses; and

(iv) reversals of impairment losses;

(c) the market value of listed investments if they are not carried at market value;

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

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

(i) the name of the investee;

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

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

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

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

6.12 Investments in securities should be distinguished between equities and debt securities. They should be analysed between those that are listed and those that are unlisted. This analysis should be provided separately for current investments and long-term investments.

6.13 An entity should disclose the existence and amounts of restrictions on title, as well as investments pledged as security separately for:

(a) the entity's liabilities; and

(b) another entity's liabilities.

Section 7
Inventories

7.1 Inventories should be measured at the lower of cost and net realisable value. Inventories are usually written down to net realisable value on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items.

7.2 The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

7.3 The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by using specific identification of their individual costs.

7.4 The cost of inventories, other than those dealt with in paragraph 7.3, should be assigned by using the first-in, first-out or weighted average cost formulas.

Recognition as an expense

7.5 When inventories are sold, the carrying amount of those inventories should be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories should be recognised as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of inventories arising from an increase in net realisable value should be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Disclosure

7.6 An entity should disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories analysed in classifications appropriate to the entity;

(c) the carrying amount of inventories pledged as security for the entity's liabilities; and

(d) the carrying amount of inventories pledged as security for another entity's liabilities.

Section 8
Construction Contracts

8.1 This Section should be applied in accounting for construction contracts in the financial statements of contractors.

8.2 Contract revenue comprises:

(a) the initial amount of revenue agreed in the contract; and

(b) variations in contract work, claims and incentive payments:

(i) to the extent that it is probable that they will result in revenue; and

(ii) they are capable of being reliably measured.

8.3 Contract costs comprise:

(a) costs that relate directly to the specific contract;

(b) costs that are attributable to contract activity in general and can be allocated to the contract; and

(c) such other costs as are specifically chargeable to the customer under the terms of the contract.

Recognition

8.4 When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 8.10.

8.5 In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(a) total contract revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the contract will flow to the entity;

(c) both the contract costs to complete the contract and the stage of contract completion at the balance sheet date can be measured reliably; and

(d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

8.6 In the case of a cost-plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(a) it is probable that the economic benefits associated with the contract will flow to the entity; and

(b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

8.7 The stage of completion of a contract may be determined in a variety of ways. The entity uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:

(a) the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;

(b) surveys of work performed; or

(c) completion of a physical proportion of the contract work.

Progress payments and advances received from customers often do not reflect the work performed.

8.8 When the outcome of a construction contract cannot be estimated reliably:

(a) revenue should be recognised only to the extent of contract costs incurred that it is probable they will be recoverable; and

(b) contract costs should be recognised as an expense in the period in which they are incurred.

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 8.10.

8.9 When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 8.4 rather than in accordance with paragraph 8.8.

Expected losses

8.10 When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

8.11 The amount of such a loss is determined irrespective of:

(a) whether work has commenced on the contract; or

(b) the stage of completion of contract activity.

Disclosure

8.12 An entity should disclose:

(a) the amount of contract revenue recognised as revenue in the period;

(b) the methods used to determine the contract revenue recognised in the period; and

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

8.13 An entity should disclose each of the following for contracts in progress at the balance sheet date:

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

(b) the amount of advances received; and

(c) the amount of retentions.

8.14 Retentions are amounts of progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts received by the contractor before the related work is performed.

8.15 An entity should present:

(a) the gross amount due from customers for contract work as an asset; and

(b) the gross amount due to customers for contract work as a liability.

8.16 The gross amount due from customers for contract work is the net amount of:

(a) costs incurred plus recognised profits; less

(b) the sum of recognised losses and progress billings,

for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings.

8.17 The gross amount due to customers for contract work is the net amount of:

(a) costs incurred plus recognised profits; less

(b) the sum of recognised losses and progress billings,

for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

Section 9
Impairment of Assets

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

9.2 In assessing whether there is any indication that an asset may be impaired, an entity should consider, as a minimum, the following indications:

External sources of information

(a) during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;

(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated;

Internal sources of information

(c) evidence is available of obsolescence or physical damage of an asset;

(d) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously expected date; and

(e) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

9.3 The list in paragraph 9.2 is not exhaustive. An entity may identify other indications that an asset may be impaired and these would also require the entity to determine the asset's recoverable amount.

9.4 Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

(a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;

(c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or

(d) operating losses or net cash outflows for the asset, when current period figures are aggregated with budgeted figures for the future.

9.5 At each balance sheet date, an entity should assess whether there is any indication that an impairment loss recognised in prior periods for an asset may no longer exist or may have decreased and, if so, estimate the recoverable amount of that asset. An entity should consider, as a minimum, the following indications:

External sources of information

(a) the asset's market value has increased significantly during the period;

(b) significant changes with a favourable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;

Internal sources of information

(c) significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs; and

(d) evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

Indications of a potential decrease in an impairment loss in this paragraph mainly mirror the indications of a potential impairment loss in paragraph 9.2.

9.6 In case of a reversal of impairment loss, the increased carrying amount of an asset should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

9.7 It is not always necessary to determine both an asset's net selling price and future net cash flow expected from the continued use of that asset. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

9.8 In some cases, estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations for determining recoverable amount. Discounting would be permitted but not required. If discounting is used, the discount rate(s) should be a pre-tax rate(s) that reflect(s) current market assessments of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted. When discounting is used, an asset's future net cash flow expected from the continued use of that asset may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Section 10
Provisions, Contingent Liabilities and Contingent Assets

10.1 A provision should be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event, excluding those arising from executory contracts, except where these are onerous;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised.

Probable outflow of resources embodying economic benefits

10.2 For a liability to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Section, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur (i.e. the probability that the event will occur is greater than the probability that it will not). Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 10.19).

Reliable estimate of the obligation

10.3 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other balance sheet items. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision. Discounting of the amount to arrive at the present value of the expenditures expected to be required to settle the obligation is permitted but not required. If discounting is used, the discount rate should be a pre-tax rate (or rates) that reflect(s) current assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

Contingent liabilities

10.4 An entity should not recognise a contingent liability.

10.5 A contingent liability is disclosed, as required by paragraph 10.19, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets

10.6 An entity should not recognise a contingent asset.

10.7 Contingent assets are not recognised in financial statements, since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

10.8 A contingent asset is disclosed, as required by paragraph 10.20, where an inflow of economic benefits is probable.

Measurement

10.9 The amount recognised as a provision should be the best estimate of the amount required to settle the present obligation at the balance sheet date.

Risks and uncertainties

10.10 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

10.11 The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

10.12 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision. Gains from the expected disposal of assets should not be taken into account when measuring a provision.

10.13 In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

10.14 Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

10.15 A provision should be used only for expenditures for which the provision was originally recognised.

10.16 Provisions should not be recognised for future operating losses.

10.17 For a contract that is onerous, a provision should be recognised and measured at the best estimate of the present obligation under the contract.

Disclosure

10.18 For each class of provision, an entity should disclose:

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

(b) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

When discounting is used to arrive at the best estimate of the provision, that fact should also be disclosed.

10.19 Unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable, an estimate of its financial effect, measured under paragraphs 10.9 and 10.10.

10.20 Where an inflow of economic benefits is probable, an entity should disclose a brief description of the nature of the contingent assets at the balance sheet date and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 10.9 and 10.10.

10.21 Where any of the information required by paragraphs 10.19 and 10.20 is not disclosed because it is not practicable to do so, that fact should be stated.

10.22 In extremely rare cases, disclosure of some or all of the information required by paragraphs 10.18 to 10.20 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information but should disclose the general nature of the dispute, together with the fact that, and the reason why, the information has not been disclosed.

Section 11
Revenue

Measurement

11.1 Revenue should be measured at the fair value of the consideration received or receivable.

Sale of goods

11.2 Revenue from the sale of goods should be recognised when all the following conditions have been satisfied:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) the amount of revenue can be measured reliably;

(d) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Rendering of services

11.3 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

11.4 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognised only to the extent of the expenses recognised that are recoverable.

11.5 “Goods” include goods produced by the entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

11.6 The rendering of services typically involves the performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to construction contracts – for example, those for the services of project managers and architects.

11.7 Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties, such as sales taxes, goods and services taxes and value-added taxes, are not economic benefits flowing to the entity and, hence, do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

Interest, royalties and dividends

11.8 Revenue arising from the use by others of entity assets yielding interest, royalties and dividends should be recognised on the bases set out in paragraph 11.9 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.

11.9 Revenue should be recognised on the following bases:

(a) interest should be recognised on a time proportion basis;

(b) royalties should be recognised on an accrual basis in accordance with the substance of the relevant agreement; and

(c) dividends should be recognised when the shareholder's right to receive payment is established.

11.10 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense rather than as an adjustment of the amount of revenue originally recognised.

Disclosure

11.11 An entity should disclose:

(a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

(b) the amount of each significant category of revenue recognised during the period, including revenue arising from:

   (i) the sale of goods;

   (ii) the rendering of services;

   (iii) interest;

   (iv) royalties; and

   (v) dividends; and

(c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

Section 12
Government Grants and Other Government Assistance

Government grants

12.1 Government grants should not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

12.2 Government grants should be recognised as income over the periods necessary to match them with the related costs they are intended to compensate, on a systematic basis. They should not be credited directly to equity.

12.3 In most cases, the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable, and thus grants in recognition of specific expenses are recognised as income in the same period as the relevant expense. Similarly, grants related to depreciable assets are usually recognised as income over the periods and in the proportions in which depreciation on those assets is charged.

12.4 A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity, with no future related costs, should be recognised as income of the period in which it becomes receivable.

12.5 Government grants related to assets should be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

12.6 Grants related to income are sometimes presented as a credit in the income statement, either separately or under a general heading such as “Other income”; alternatively, they are deducted in reporting the related expense.

12.7 A government grant that becomes repayable should be accounted for as a revision to an accounting estimate. Repayment of a grant related to income should be applied first against any unamortised deferred credit set up in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or where no deferred credit exists, the repayment should be recognised immediately as an expense. Repayment of a grant related to an asset should be recorded by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised to date as an expense in the absence of the grant should be recognised immediately as an expense.

Government assistance

12.8 Excluded from the definition of government grants are certain forms of government assistance that cannot reasonably have a value placed on them and transactions that cannot be distinguished from the normal trading transactions of the entity.

12.9 Examples of assistance that cannot reasonably have a value placed on them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity’s sales. The existence of the benefit might be unquestioned, but any attempt to segregate the trading activities from government assistance could well be arbitrary.

12.10 The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements will not be misleading.

12.11 Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest.

12.12 Government assistance to entities meets the definition of government grants 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 should therefore not be credited to equity.

Disclosure

12.13 An entity should disclose:

(a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;

(b) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and

(c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Section 13
Borrowing Costs

13.1 Borrowing costs may include:

(a) interest on bank overdrafts and short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of finance leases; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Borrowing costs: benchmark treatment

13.2 Borrowing costs should be recognised as an expense in the period in which they are incurred.

Borrowing costs: allowed alternative treatment

13.3 Borrowing costs should be recognised as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 13.4.

13.4 Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Section.

13.5 Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and properties held for investment potential. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Borrowing costs eligible for capitalisation

13.6 To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

13.7 To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

13.8 The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when:

(a) expenditures for the asset are being incurred;

(b) borrowing costs are being incurred; and

(c) activities that are necessary to prepare the asset for its intended use or sale are in progress.

13.9 Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.

13.10 Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

13.11 When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

Disclosure

13.12 An entity should disclose:

(a) the accounting policy adopted for borrowing costs;

(b) the total borrowing costs incurred during the period;

(c) the amount of borrowing costs capitalised during the period; and

(d) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Section 14
Income Taxes

Current tax

14.1 Current tax for current and prior periods should, to the extent unpaid, be recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognised as an asset.

14.2 The benefit relating to a tax loss that can be carried back to recover current tax of a previous period should be recognised as an asset.

14.3 Current tax liabilities (assets) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

14.4 Deferred tax liabilities (assets) (that is, the amounts of income taxes payable (recoverable) in future periods in respect of taxable temporary differences (deductible temporary differences and the carryforward of unused tax losses and tax credits)) should not be recognised.

14.5 Current tax should be recognised as income or an expense and included in the profit or loss for the period, except to the extent that the tax arises from a transaction or event that is recognised other than in the income statement.

14.6 Current tax should be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

Presentation

14.7 Current tax assets and current tax liabilities should be presented separately from other assets and liabilities in the balance sheet.

14.8 An entity should offset current tax assets and current tax liabilities if, and only if, the entity:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Disclosure

14.9 An entity should disclose:

(a) the accounting policy adopted for income taxes; and

(b) major components of tax expense (income).

14.10 Components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods; and

(c) the amount of benefit arising from a previously unrecognised tax loss or tax credit of a prior period that is used to reduce current tax expense.

Section 15
The Effects of Changes in Foreign Exchange Rates

Foreign currency transactions

15.1 A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

15.2 At each balance sheet date:

(a) foreign currency monetary items should be reported using the closing rate; and

(b) non-monetary items (including investments in subsidiaries, associates and joint ventures) denominated in a foreign currency should be reported using the exchange rate at the date of the transaction or event (for example, the recognition and reversal of an impairment loss).

15.3 Exchange differences arising on the settlement of monetary items or on reporting an entity's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise.

Translation of a foreign branch

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

(a) assets and liabilities for each balance sheet presented (i.e. including comparatives) should be translated at the closing rate at the date of that balance sheet;

(b) income and expenses for each income statement (i.e. including comparatives) should be translated at average rate for the period or closing rate at that balance sheet date; and

(c) all resulting exchange differences should be recognised as a separate component of equity.

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

Forward contracts

15.6 Where a non-speculative forward contract is used as a hedge of a net monetary asset or liability the gain or loss on the contract should be taken to the income statement and the discount or premium may be either amortised over the period of the contract or taken to the income statement.

15.7 Where a non-speculative forward contract is used as a hedge of a firm commitment no gain or loss need normally be recognised during the commitment period. At the end of that period any gain or loss will be added to, or deducted from, the amount of the relevant transaction. The discount or premium should be either amortised over the period of the contract or deferred with the gain or loss.

15.8 Where a forward contract is speculative the gain or loss should be credited or charged to the income statement.

Disclosure

15.9 An entity should disclose:

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

(b) the amount of exchange differences included in the profit or loss for the period; and

(c) net exchange differences recognised as a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

Section 16
Related Party Disclosures

16.1 This Section deals only with the identification and disclosure of related party relationships and transactions. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

16.2 In the context of this Section the following are deemed not to be related parties:

(a) two companies simply because they have a director in common, (but it is necessary to consider the possibility, and to assess the likelihood, that the director would be able to affect the policies of both companies in their mutual dealings);

(b) two venturers simply because they share joint control over a joint venture;

(c) (i) providers of finance;

(ii) trade unions;

(iii) public utilities; and

(iv) government departments and agencies, in the course of their normal dealings with an entity by virtue only of those dealings (although they may circumscribe the freedom of action of an entity or participate in its decision-making process); and

(d) a single customer, supplier, franchisor, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence.

Disclosure

16.3 An entity should disclose the name of the entity's parent and, if different, the ultimate controlling company irrespective of whether there have been transactions between those related parties.

16.4 An entity should disclose the total remuneration of key management personnel.

16.5 If there have been transactions between related parties, an entity should disclose the nature of the related party relationships as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to the requirements in paragraph 16.4 to disclose key management personnel compensation. At a minimum, disclosures should include:

(a) the amount of the transactions;

(b) the amount of outstanding balances and:

(i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

(ii) details of any guarantees given or received;

(c) provisions for doubtful debts related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

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

(a) the parent;

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

(c) associates;

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

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

(f) other related parties.

16.7 The following are examples of situations where related party transactions may lead to disclosures by an entity in the period they affect:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other assets;

(c) rendering or receiving of services;

(d) leases;

(e) transfers of research and development;

(f) transfers under licence agreements;

(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);

(h) provision of guarantees or collateral; and

(i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.

16.8 Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements.

Section 17
Events After the Balance Sheet Date

17.1 An entity should adjust the amounts recognised in its financial statements to reflect adjusting events after the balance sheet date.

17.2 The following are examples of adjusting events after the balance sheet date that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) the resolution after the balance sheet date of a court case that, because it confirms that an entity already had a present obligation at the balance sheet date, requires the entity to adjust a provision already recognised, or to recognise a provision instead of merely disclosing a contingent liability;

(b) the receipt of information after the balance sheet date indicating that an asset was impaired at the balance sheet date, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:

(i) when the bankruptcy of a customer occurs after the balance sheet date, it usually confirms that a loss already existed at the balance sheet date on a trade receivable account and that the entity needs to adjust the carrying amount of the trade receivable account; and

(ii) the sale of inventories after the balance sheet date may give evidence about their net realisable value at the balance sheet date;

(c) the determination after the balance sheet date of the cost of assets purchased, or the proceeds from assets sold, before the balance sheet date;

(d) the determination after the balance sheet date of the amount of profit-sharing or bonus payments, if the entity had a present legal or constructive obligation at the balance sheet date to make such payments as a result of events before that date; and

(e) the discovery of fraud or errors indicating that the financial statements were incorrect.

17.3 An entity should not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the balance sheet date.

17.4 An example of a non-adjusting event after the balance sheet date is a decline in market value of investments between the balance sheet date and the date when the financial statements are authorised for issue. The fall in market value does not normally relate to the condition of the investments at the balance sheet date, but reflects circumstances that arise in the following period. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the balance sheet date, although it may need to give additional disclosure under paragraph 17.8.

17.5 If dividends to holders of equity instruments (for example, ordinary shares, certain preferred shares, warrants or options to purchase ordinary shares) are declared after the balance sheet date, an entity should not recognise those dividends as a liability at the balance sheet date.

17.6 An entity should not prepare its financial statements on a going concern basis if management determines, after the balance sheet date, either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Disclosure

17.7 If an entity receives information after the balance sheet date about conditions that existed at the balance sheet date, the entity should, in the light of the new information, update disclosures that relate to these conditions.

17.8 Where non-adjusting events after the balance sheet date are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, an entity should disclose the following information for each significant category of non-adjusting event after the balance sheet date:

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

17.9 The following are examples of non-adjusting events after the balance sheet date that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions:

(a) announcing a plan to discontinue an operation;

(b) major purchases and disposals of assets, or expropriation of major assets by government; and

(c) the destruction of a major production plant by a fire after the balance sheet date.

17.10 An entity should disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the entity's owners or others have the power to amend the financial statements after issuance, the entity should disclose that fact.

Transitional Provisions

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

Effective Date

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

Appendix 1
Examples of Application

This appendix is illustrative only and does not form part of the SME-FRS. The purpose of this appendix is to illustrate the application of the related Sections of the SME-FRS and to assist in clarifying their meaning.

A. RECOGNITION OF PROVISIONS

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. Based on past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event: The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement: Probable for the warranties as a whole.

Conclusion: A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.

Example 2: Legal Requirement to Fit Smoke Filters

Under new legislation, an entity is required to install smoke filters in its factories by 30 June 20X2. The entity has not fitted the smoke filters.

(a) At the balance sheet date of 31 December 20X1

Present obligation as a result of a past obligating event: There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion: No provision is recognised for the cost of fitting the smoke filters.

(b) At the balance sheet date of 31 December 20X2

Present obligation as a result of a past obligating event: There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement: The likelihood of incurring fines and penalties for non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion: No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example 3: A Court Case

After a wedding in 20X0, 10 people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are underway seeking damages from the entity, but it disputes its liability. Up to the date of approval of the financial statements for the year to 31 December 20X0 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year ending 31 December 20X1, its lawyers advise that, because of new developments in the case, it is probable that the entity will be found liable.

(a) At the balance sheet date of 31 December 20X0

Present obligation as a result of a past obligating event: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion: No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At the balance sheet date of 31 December 20X1

Present obligation as a result of a past obligating event: On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognised for the best estimate of the amount required to settle the obligation.

Example 4: Refurbishment Costs – No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No provision is recognised.

The cost of replacing the lining is not recognised because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions; even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes into account its consumption (i.e. it is depreciated over five years). The relining costs then incurred are capitalised, with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 5: Long Service Payments

Under the Employment Ordinance, an entity is required to make long service payments to its employees upon the termination of their employment or retirement when the employee fulfils certain conditions and the termination meets the required circumstances. However, where an employee is simultaneously entitled to a long service payment and to a retirement scheme payment, the amount of the long service payment may be reduced by certain benefits arising from the retirement scheme. Based on the entity's past experience and the directors' knowledge of the business and work force, it is probable that the entity will have to make long service payments to some employees on termination of their employment or retirement.

Present obligation as a result of a past obligating event: The obligating event is the employment of its work force which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognised for the best estimate of the long service payments that are required to be made to the employees of the entity in respect of their services to date less any amounts that would be expected to be met out of the entity's retirement scheme.

Example 6: Building Management Ordinance

The Building Management Ordinance section 20(2) suggests the (Owners) Corporation to consider establishing a contingency fund to provide for any expenditure of an unexpected or urgent nature. In line with the above, a Maintenance and Repair Fund is normally established by a property management company in order to provide funds for the estimated cost of anticipated maintenance, redecoration and repair works that will be undertaken in the foreseeable future on the premises. Should a provision for such repairs and maintenance be recognised in the financial statements?

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No provision is recognised.

However, the SME-FRS neither encourages nor prohibits the segregation of funds to meet future obligations as suggested by the Building Management Ordinance.

B. REVENUE RECOGNITION

The following examples illustrate the application of Section 11 of the SME-FRS in a number of commercial situations in order to clarifying its meaning. The examples focus on particular aspects of a transaction and do not constitute comprehensive discussions of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably; that it is probable that the economic benefits will flow to the entity; and that the costs incurred or to be incurred can be measured reliably. The examples do not modify or override the SME-FRS.

Sale of Goods

Since laws vary from country to country, the recognition criteria in the SME-FRS will be met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

1. ***"Bill and hold" sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing***

Revenue is recognised when the buyer takes title, provided:

(a) it is probable that delivery will be made;

(b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;

(c) the buyer specifically acknowledges the deferred delivery instructions; and

(d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

2. ***Goods shipped subject to conditions, including the following situations:***

(a) *Installation and inspection*

Revenue is normally recognised when the buyer accepts delivery and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

(i) the installation process is simple in nature (e.g. the installation of a factory-tested television receiver which only requires unpacking and connection of power and antenna); or

(ii) the inspection is performed only for purposes of final determination of contract prices (e.g. for shipments of iron ore, sugar or soya beans).

(b) *On approval when the buyer has negotiated a limited right of return*

If there is uncertainty about the possibility of return, revenue is recognised when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

(c) *Consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)*

Revenue is recognised by the shipper when the goods are sold by the recipient to a third party.

(d) *Cash on delivery sales*

Revenue is recognised when delivery is made and cash is received by the seller or its agent.

3. ***Lay away sales, in which the goods are delivered only when the buyer makes the final payment in a series of instalments***

Revenue from such sales is recognised when the goods are delivered. However, when experience indicates that most of such sales are consummated, revenue may be recognised when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

4. ***Orders in which payment (or partial payment) is received in advance of delivery for goods not presently held in inventory (e.g. the goods are still to be manufactured or will be delivered directly to the customer from a third party)***

Revenue is recognised when the goods are delivered to the buyer.

5. ***Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase by the seller of the goods***

The terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

6. ***Sales to intermediate parties, such as distributors, dealers or others, for resale***

Revenue from such sales is generally recognised when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

7. ***Subscriptions to publications and similar items***

When the items involved are of similar value in each time period, revenue is recognised on a straight-line basis over the period in which the items are despatched. When the items vary in value from period to period, revenue is recognised on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

8. ***Instalment sales, under which the consideration is receivable in instalments***

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, on a time proportion basis that takes into account the imputed rate of interest.

9. ***Real estate sales***

Revenue is normally recognised when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and, therefore, the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognise revenue. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognised as the acts are performed. An example is a building or other facility on which construction has not been completed.

In some cases, real estate may be sold with a degree of continuing involvement by the seller such that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determine how the transaction is accounted for. It may be accounted for as a sale, or as a financing, a leasing or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

A seller must also consider the means of payment and evidence of the buyer's commitment to complete payment. For example, when the aggregate of the payments received, including the buyer's initial down payment or continuing payments by the buyer, provide insufficient evidence of the buyer's commitment to complete payment, revenue is recognised only to the extent that cash is received.

Rendering of Services

10. ***Installation fees***

Installation fees are recognised as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

11. ***Servicing fees included in the price of the product***

When the selling price of a product includes an identifiable amount for subsequent servicing (e.g. after sales support and product enhancement on the sale of software), that amount is deferred and recognised as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

12. ***Advertising commissions***

Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

13. ***Insurance agency commissions***

Insurance agency commissions received or receivable that do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognised as revenue over the period during which the policy is in force.

14. ***Admission fees***

Revenue from artistic performances, banquets and other special events is recognised when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

15. ***Tuition fees***

Revenue is recognised over the period of instruction.

16. ***Initiation, entrance and membership fees***

Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to the purchase of goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

17. ***Franchise fees***

Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

(a) *Supplies of equipment and other tangible assets*

The amount, based on the fair value of the assets sold, is recognised as revenue when the items are delivered or title passes.

(b) *Supplies of initial and subsequent services*

Fees for the provision of continuing services, whether part of the initial fee or a separate fee are recognised as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period during which the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (e.g. assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

If the initial fee is collectable over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

(c) *Continuing franchise fees*

Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

(d) *Agency transactions*

Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor's acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

18. ***Fees from the development of customised software***

Fees from the development of customised software are recognised as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

19. ***Licence fees and royalties***

Fees and royalties paid for the use of an entity's assets (e.g. trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognised in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely such that the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Appendix 2
Illustrative Financial Statements Prepared in Accordance with the SME-FRS

This appendix is illustrative only and does not form part of the SME-FRS. The purpose of this appendix is to illustrate the application of the SME-FRS and to assist in clarifying its meaning. It is prepared in compliance with the SME-FRF.

It should be noted that:

(a) Under SME-FRS 1.26, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity should be presented either on the face of the income statement or in the notes to the income statement. The presentation adopted is consistent with the former.

(b) Under SME-FRS 1.29, changes in equity can be presented either in the notes to the financial statements or as a separate component of the financial statements. The presentation adopted is consistent with the former.

SME LIMITED
INCOME STATEMENT
for the year ended 31 December 20X5

	Note	**20X5 HK$**	**20X4 HK$**
Revenue	2	29,054,180	24,834,610
Cost of sales		(19,114,120)	(16,490,300)
		9,940,060	8,344,310
Other income		23,680	23,060
Distribution costs		(702,200)	(627,200)
Administrative expenses		(7,240,955)	(5,901,420)
Other operating expenses		(423,050)	(400,120)
Finance costs	3	(53,530)	(63,130)
Profit before tax	4	1,544,005	1,375,500
Income tax expense	6	(225,050)	(225,430)
Profit for the year		1,318,955	1,150,070

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME LIMITED
BALANCE SHEET
as at 31 December 20X5

	Note	20X5 HK$	20X4 HK$
Non-current assets			
Property, plant and equipment	7	5,270,300	4,104,010
Intangible assets	8	2,100,000	2,400,000
Long-term investments	9	430,000	400,000
		7,800,300	6,904,010
Current assets			
Inventories	10	1,938,680	1,964,590
Prepayments		147,040	261,910
Trade and other receivables		2,115,150	2,113,535
Current investment	11	200,000	-
Cash and bank balances		106,800	83,500
		4,507,670	4,423,535
Less: **Current liabilities**			
Income tax payable		(225,050)	(225,430)
Bank overdraft – secured	12	(318,840)	(533,520)
Bank loan due within 12 months – secured	12	(300,000)	(300,000)
Obligations under finance leases	13	(117,630)	(62,805)
Trade payables		(1,892,530)	(1,702,250)
Due to related parties	17	(360,300)	(343,900)
		(3,214,350)	(3,167,905)
Net Current Assets		1,293,320	1,255,630
Non-current liabilities			
Bank loan – secured	12	(100,000)	(400,000)
Obligations under finance leases	13	(89,770)	(64,745)
		(189,770)	(464,745)
NET ASSETS		8,903,850	7,694,895
Equity			
Share capital			
Authorised: 100,000 ordinary shares of HK$1 each			
Issued & fully paid: 100,000 ordinary shares of HK$1 each	14	100,000	100,000
Retained earnings	14	8,803,850	7,594,895
		8,903,850	7,694,895

Approved by: ____________________ ____________________

Director Director

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME LIMITED
ACCOUNTING POLICIES AND EXPLANATORY NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 20X5

Reporting entity

SME Limited is a company incorporated in Hong Kong with limited liability. The company's registered office is located at 9/F, 28 Nowhere Street, Kowloon, Hong Kong. The principal activity of the company is trading of toys. The company has adopted a trade name "Fun Times" for its business.

1. Basis of preparation and accounting policies

The company qualifies under the Companies Ordinance to prepare and present its financial statements in accordance with section 141D of that Ordinance. The company's shareholders have unanimously agreed in writing to apply section 141D with respect to the company's financial statements for the year ended 31 December 20X5.

These financial statements comply with the Small and Medium-sized Entity Financial Reporting Standard issued by the Hong Kong Institute of Certified Public Accountants and have been prepared under the accrual basis of accounting and on the basis that the company is a going concern.

The measurement base adopted is the historical cost convention.

The following are the specific accounting policies that are necessary for a proper understanding of the financial statements:

(a) Revenue

Revenue is recognised when it is probable that the economic benefits will flow to the company and when the revenue can be measured reliably, on the following bases:

(i) sale of goods is recognised when the goods are delivered and the risks and rewards of ownership have passed to the customer;

(ii) rental income is recognised on a time proportion basis over the lease terms;

(iii) interest income is recognised on a time proportion basis taking into account the principal outstanding and the interest applicable; and

(iv) dividend income is recognised when the shareholder's right to receive payment is established.

(b) Borrowing costs

Borrowing costs are recognised as an expense in the period in which they are incurred.

(c) Foreign exchange

Foreign currency transactions are converted at the exchange rate applicable at the transaction date. Foreign currency monetary items are translated into Hong Kong Dollars using exchange rates applicable at the balance sheet date. Gains and losses on foreign exchange are recognised in the income statement.

(d) Taxation

Income tax expense represents current tax expense. The income tax payable represents the amounts expected to be paid to the taxation authority, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is not provided.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

The depreciable amount of an item of property, plant and equipment is allocated on a systematic basis over its estimated useful life using the straight-line method. The principal annual rates used for depreciation are as follows:

Leasehold land	Over the lease terms
Buildings	2%
Furniture, fixtures and equipment	10%-20%

(f) Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses and are amortised on a systematic basis over their estimated useful lives using the straight-line method.

(g) Investments in securities

Current investments are stated at the lower of cost and net realisable value. Long-term investments are stated at cost less accumulated impairment losses.

(h) Impairment of assets

An assessment is made at each balance sheet date to determine whether there is any indication of impairment or reversal of previous impairment, including items of property, plant and equipment, intangible assets and long-term investments. In the event that an asset's carrying amount exceeds its recoverable amount, the carrying amount is reduced to recoverable amount and an impairment loss is recognised in the income statement. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount, however not to an amount higher than the carrying amount that would have been determined (net of amortisation or depreciation), had no impairment losses been recognised for the asset in prior years.

(i) Leases

Leases that transfer substantially all the rewards and risks of ownership of assets to the company, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where substantially all the risks and rewards of ownership of assets are not transferred to the lessee are accounted for as operating leases. Annual rents applicable to such operating leases are charged to the income statement on a straight-line basis over the lease term.

(j) Inventories

Inventories are stated at the lower of cost (using a first-in-first-out basis) and net realisable value. In arriving at net realisable value an allowance has been made for deterioration and obsolescence.

(k) Trade and other receivables

Trade and other receivables are stated at estimated realisable value after each debt has been considered individually. Where the payment of a debt becomes doubtful a provision is made and charged to the income statement.

2. Revenue

An analysis of the company's revenue is as follows:

	20X5 HK$	20X4 HK$
Sale of goods	28,957,860	24,753,540
Rental income	78,000	68,000
Interest income	6,200	5,600
Dividend income	12,120	7,470
	29,054,180	24,834,610

3. Finance costs

	20X5 HK$	20X4 HK$
Interest on bank loan and overdraft	41,030	55,100
Interest on finance leases	12,500	8,030
	53,530	63,130

4. Profit before tax

Profit before tax is arrived at:

	Note	20X5 HK$	20X4 HK$
After crediting the following item:			
Gain on disposal of property, plant and equipment		23,680	23,060
And after charging the following items:			
Depreciation	7	(565,770)	(322,820)
Amortisation*	8	(300,000)	(300,000)
Key management personnel's remuneration		(762,850)	(470,000)
Other staff costs		(1,522,570)	(1,968,920)
Exchange losses, net		(16,250)	(19,920)
Provision for inventories		(106,000)	(86,700)
Provision for bad and doubtful debts		(98,800)	(65,600)

* The amortisation of acquired brand name for the year is included in "Other operating expenses" on the face of the income statement.

5. Directors' remuneration

Directors' remuneration disclosed pursuant to section 161 of the Companies Ordinance is as follows:

	20X5 HK$	20X4 HK$
Fees	350,000	350,000
Other emoluments	120,000	120,000

6. Income tax expense

Hong Kong profits tax has been provided at the rate of 17.5% (20X4: 17.5%) on the estimated assessable profits arising in Hong Kong during the year.

	20X5 HK$	20X4 HK$
Tax charge for the year	235,250	225,430
Overprovision in prior years	(10,200)	-
	225,050	225,430

7. Property, plant and equipment

	Leasehold land and buildings HK$	Furniture, fixtures and equipment HK$	Total HK$
Cost:			
At 1 January 20X5	5,040,000	2,428,180	7,468,180
Additions	-	2,381,530	2,381,530
Disposals	-	(1,527,470)	(1,527,470)
At 31 December 20X5	5,040,000	3,282,240	8,322,240
Accumulated depreciation and impairment losses:			
At 1 January 20X5	2,160,000	1,204,170	3,364,170
Depreciation for the year	80,000	485,770	565,770
Written back on disposal	-	(878,000)	(878,000)
At 31 December 20X5	2,240,000	811,940	3,051,940
Net carrying amount:			
At 31 December 20X5	2,800,000	2,470,300	5,270,300
At 31 December 20X4	2,880,000	1,224,010	4,104,010

The carrying amount of equipment held under finance leases at 31 December 20X5 was HK$205,500 (20X4: HK$108,000).

8. Intangible assets

	HK$
Acquired brand name	
Cost:	
At 1 January and 31 December 20X5	3,000,000
Accumulated amortisation:	
At 1 January 20X5	600,000
Amortisation for the year	300,000
At 31 December 20X5	900,000
Net carrying amount:	
At 31 December 20X5	2,100,000
At 31 December 20X4	2,400,000

The acquired brand name is amortised over 10 years.

9. Long-term investments

	20X5 HK$	20X4 HK$
Listed equity securities, at cost	430,000	400,000

The market value of listed equity securities as at 31 December 20X5 was HK$525,190 (20X4: HK$552,740).

10. Inventories

Inventories comprise entirely of stock in trade.

11. Current Investment

Current investment represents an investment in an equity linked note with a term of six months and its return is dependent on the performance of a single security.

12. Secured bank loan and overdraft

	20X5 HK$	20X4 HK$
Bank loan		
HK$900,000 3 year loan		
– fully repayable in September 20X7	400,000	700,000
Less: Current Portion	(300,000)	(300,000)
Non-current Portion	100,000	400,000

The company's bank loan and overdraft are secured by a floating charge over the company's assets.

13. Obligations under finance leases

The present value of lease payments under finance leases are as follows:

	20X5 HK$	20X4 HK$
Not later than one year	117,630	62,805
Later than one year	89,770	64,745
	207,400	127,550

14. Changes in equity

	Share capital HK$	Retained earnings HK$	Total HK$
Balance as at 31 December 20X4	100,000	7,594,895	7,694,895
Profit for the year	–	1,318,955	1,318,955
Dividend paid (Interim dividend of HK$1.1 per share)	–	(110,000)	(110,000)
Balance as at 31 December 20X5	100,000	8,803,850	8,903,850

15. Commitments under operating leases

The company had the following total future minimum lease payments payable under non-cancellable operating leases:

	20X5 HK$	20X4 HK$
Not later than one year	573,060	573,060
Later than one year	573,060	1,146,120
	1,146,120	1,719,180

16. Contingent liabilities

The company had the following contingent liabilities not provided for in the financial statements:

	20X5 HK$	20X4 HK$
Guarantees given to banks in connection with facilities granted to related companies	197,120	–

Mr. X, a shareholder of the company, controls both the company and the related companies.

17. Related party transactions

In addition to the transactions and balances detailed elsewhere in these financial statements, the Company had the following transactions with related parties:

	20X5 HK$	20X4 HK$
Goods sold to related companies	393,500	372,840
Goods purchased from related companies	1,519,400	2,505,920

Mr. X, a shareholder of the company, controls both the company and the related companies.

The amounts due to related parties are unsecured, interest-free and have no fixed terms of repayment.

18. Approval of financial statements

These financial statements were authorised for issue by the company's Board of Directors on 15 March 20X6.