HKFRS for Private Entities (Revised)
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Effective for financial statements which cover a period beginning on or after 1 January 2017
Early application is permitted

Hong Kong Financial Reporting Standard for Private Entities

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

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The *Hong Kong Financial Reporting Standard for Private Entities (HKFRS for Private Entities)* is set out in Sections 1–35 and Appendices A-B. Terms defined in the Glossary are in **bold type** the first time they appear in each section, as appropriate. The *HKFRS for Private Entities* is accompanied by a Preface, a Derivation Table, a Basis for Conclusions and implementation Guidance consisting of illustrative financial statements and a table that collates the presentation and disclosure requirements in the *HKFRS for Private Entities*.

Preface to HKFRS for Private Entities

The Hong Kong Institute of Certified Public Accountants (HKICPA)

P1 Pursuant to section 18A of the Professional Accountants Ordinance (Chapter 50), Council of HKICPA (Council) may, in relation to the practice of accountancy, issue or specify any standards of accounting practice required to be observed, maintained or otherwise applied by members of HKICPA. Approval of Hong Kong Financial Reporting Standards (HKFRSs) and related documents, such as the Framework for the Preparation and Presentation of Financial Statements (Framework), exposure drafts, and other discussion documents, is the responsibility of Council.

P2 Council has mandated its Financial Reporting Standards Committee (FRSC) to develop financial reporting standards to achieve convergence with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). Within this remit, Council permits FRSC to work in whatever way it considers most effective and efficient and this may include forming advisory sub-committees or other forms of specialist advisory groups to give advice in preparing new and revised HKFRSs.

P3 FRSC is also responsible for providing timely guidance on newly identified financial reporting issues not specifically addressed in HKFRSs or issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop. It thus promotes the rigorous and uniform application of HKFRSs.

P4 HKICPA's Standards & Quality Accountability Board (SQAB) is responsible for reviewing and advising on HKICPA's overall strategy, policies and processes for setting financial reporting standards. One of the SQAB's main objectives is to give advice to FRSC on priorities and on major standard-setting projects.

P5 In 2001, Council adopted the policy of achieving convergence of HKFRSs with IFRSs. Council's objectives in this respect are:

(a) to develop, in the public interest, a single set of high quality, understandable and enforceable financial reporting standards based on clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the capital markets and other users of financial information make economic decisions;

(b) to promote the use and rigorous application of those standards;

(c) to promote, support and enforce compliance with those standards by members of HKICPA whether as preparers or auditors of financial information; and

(d) to maintain convergence of financial reporting standards with IFRSs.

HKFRSs

P6 HKICPA achieves its objectives primarily by developing and publishing HKFRSs and promoting the use of those standards in **general purpose financial statements** and other financial reporting. Other financial reporting comprises information provided outside **financial statements** that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions. The term 'financial reporting' encompasses general purpose financial statements plus other financial reporting.

P7 HKFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements. They may also set out such requirements for transactions, events and conditions that arise mainly in specific industries. HKFRSs are based on the Framework, which addresses the concepts underlying the information presented in general purpose financial statements. The objective of the Framework is to facilitate the consistent and logical formulation of HKFRSs. It also provides a basis for the use of judgment in resolving accounting issues.

General purpose financial statements

P8 HKFRSs are designed to apply to general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. The objective of financial statements is to provide information about the **financial position, performance** and **cash flows** of an entity that is useful to those users in making economic decisions.

P9 General purpose financial statements are those directed to general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. General purpose financial statements include those that are presented separately or within another public document such as an annual report or a prospectus.

The HKFRS for Private Entities

P10 The IASB has also developed and published a separate standard intended to apply to general purpose financial statements of, and other financial reporting by, entities that in many countries are referred to by a variety of terms, including **small and medium-sized entities** (SMEs), private entities, and non-publicly accountable entities. That standard is the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs), which was issued in July 2009.

P11 Many jurisdictions around the world have developed their own definitions of SMEs for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantified criteria based on revenue, assets, employees or other factors. Frequently, the term SMEs is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.

P12 In this regard, Council considers that IFRS for SMEs should be adopted in Hong Kong as a reporting option for eligible private entities. Accordingly, this HKFRS for Private Entities is based on IFRS for SMEs by replacing the term “SMEs” in IFRS for SMEs by “Private Entities” to suit Hong Kong's circumstances. The term “SMEs” is widely used in Hong Kong and associated with the locally developed SME-FRF&FRS. For clarity and differentiation, this HKFRS which is based on “IFRS for SMEs” is to be called “Hong Kong Financial Reporting Standard for Private Entities” (HKFRS for Private Entities).

Authority of HKFRS for Private Entities

P13 Council approved the adoption of HKFRS for Private Entities as a **financial reporting option** for Private Entities. Private Entities are companies that:

(a) do not have public accountability (see Paragraph 1.3 for definition of public accountability); and

(b) publish general purpose financial statements for external users.

P14 The scope and applicability of HKFRSs and SME-FRF&FRS are unchanged and preparers can continue to use HKFRSs or SME-FRF&FRS to prepare their financial statements even though they are qualified to use HKFRS for Private Entities, if they wish to do so.

Organisation of HKFRS for Private Entities

P15 The HKFRS for Private Entities is organised by topic, with each topic presented in a separate numbered section. Cross-references to paragraphs are identified by section number followed by paragraph number. Paragraph numbers are in the form xx.yy, where xx is the section number and yy is the sequential paragraph number within that section. In examples that include monetary amounts, the measuring unit is Currency Units (abbreviated as CU).

P16 All of the paragraphs in the HKFRS for Private Entities have equal authority. Some sections include appendices of implementation guidance that are not part of the HKFRS for Private Entities but, rather, are guidance for applying it.

Maintenance of HKFRS for Private Entities

P17 HKICPA expects to undertake a review of HKFRS for Private Entities in accordance with the IASB timetable to review its IFRS for SMEs. The IASB expects to propose amendments to the IFRS for SMEs by publishing an omnibus exposure draft periodically, but not more frequently than approximately once every three years. In developing those exposure drafts, it expects to consider new and amended full IFRS Standards as well as specific issues that have been brought to its attention regarding application of the IFRS for SMEs. On occasion, the IASB may identify an urgent matter for which amendment of the IFRS for SMEs may need to be considered outside the periodic review process. However, such occasions are expected to be rare.

P18 Until the IFRS for SMEs is amended, any changes that the IASB may make or propose with respect to full IFRSs do not apply to the IFRS for SMEs. Consistent with the current due process of HKICPA, comments will be invited publicly for the IASB omnibus exposure draft. FRSC will consider revising the HKFRS for Private Entities based on the IASB revisions to IFRS for SMEs. The HKFRS for Private Entities is a stand-alone document. Entity shall not anticipate or apply changes made in full HKFRSs before those changes are incorporated into the HKFRS for Private Entities unless, in the absence of specific guidance in the HKFRS for Private Entities, an entity chooses to apply guidance in full HKFRSs and those principles do not conflict with requirements in the hierarchy in paragraphs 10.4–10.5.

P19 The IASB expects that there will be a period of at least one year between when amendments to the IFRS for SMEs are issued and the effective date of those amendments. HKICPA will closely follow the timetable of IASB and intends to provide a comparable period to the users for their adaptation when amendments are issued to HKFRS for Private Entities.

Hong Kong Financial Reporting Standard (HKFRS) for Private Entities

Section 1
Private Entities

Intended scope of this HKFRS

1.1 The *HKFRS for Private Entities* is intended for use by **private entities** (Private Entities). This section describes the characteristics of Private Entities.

Description of private entities

1.2 Private entities are entities that:

(a) do not have **public accountability**, and

(b) publish **general purpose financial statements** for external users.

Examples of external users include **owners** who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

1.3 An entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

1.4 Some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services such as utility companies), that does not make them publicly accountable.

1.5 If a publicly accountable entity uses this Standard, its financial statements shall not be described as conforming to the *HKFRS for Private Entities*.

1.6 A **subsidiary** whose **parent** uses **full HKFRSs** or **IFRSs**, or that is part of a consolidated **group** that uses full HKFRSs or IFRSs, is not prohibited from using this Standard in its own financial statements if that subsidiary by itself does not have public accountability. If its financial statements are described as conforming to the *HKFRS for Private Entities*, it must comply with all of the provisions of this Standard.

1.7 A parent entity (including the ultimate parent or any intermediate parent) assesses its eligibility to use this Standard in its **separate financial statements** on the basis of its own status without considering whether other group entities have, or the group as a whole has, public accountability. If a parent entity by itself does not have public accountability, it may present its separate financial statements in accordance with this Standard (see Section 9 *Consolidated and Separate Financial Statements*), even if it presents its **consolidated financial statements** in accordance with full HKFRSs or another set of generally accepted accounting principles (GAAP), such as its national accounting standards. Any financial statements prepared in accordance with this Standard shall be clearly distinguished from financial statements prepared in accordance with other requirements.

Section 2
Concepts and Pervasive Principles

Scope of this section

2.1 This section describes the **objective of financial statements** of **private entities** (Private Entities) and the qualities that make the information in the **financial statements** of Private Entities useful. It also sets out the concepts and basic principles underlying the financial statements of Private Entities.

Objective of financial statements of private entities

2.2 The objective of financial statements of a private entity is to provide information about the **financial position, performance** and **cash flows** of the entity that is useful for economic decision-making by a broad range of users of the financial statements who are not in a position to demand reports tailored to meet their particular information needs.

2.3 Financial statements also show the results of the stewardship of management—the accountability of management for the resources entrusted to it.

Qualitative characteristics of information in financial statements

Understandability

2.4 The information provided in financial statements should be presented in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, the need for **understandability** does not allow relevant information to be omitted on the grounds that it may be too difficult for some users to understand.

Relevance

2.5 The information provided in financial statements must be relevant to the decision-making needs of users. Information has the quality of **relevance** when it is capable of influencing the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

Materiality

2.6 Information is **material**—and therefore has relevance—if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. However, it is inappropriate to make, or leave uncorrected, immaterial departures from the *HKFRS for Private Entities* to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Reliability

2.7 The information provided in financial statements must be reliable. Information is reliable when it is free from material **error** and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. Financial statements are not free from bias (ie not neutral) if, by the selection or presentation of information, they are intended to influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Substance over form

2.8 Transactions and other events and conditions should be accounted for and presented in accordance with their substance and not merely their legal form. This enhances the **reliability** of financial statements.

Prudence

2.9 The uncertainties that inevitably surround many events and circumstances are acknowledged by the disclosure of their nature and extent and by the exercise of **prudence** in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that **assets** or **income** are not overstated and **liabilities** or **expenses** are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.

Completeness

2.10 To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

2.11 Users must be able to compare the financial statements of an entity through time to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities to evaluate their relative financial position, performance and cash flows. Hence, the **measurement** and display of the financial effects of like transactions and other events and conditions must be carried out in a consistent way throughout an entity and over time for that entity, and in a consistent way across entities. In addition, users must be informed of the **accounting policies** employed in the preparation of the financial statements, and of any changes in those policies and the effects of such changes.

Timeliness

2.12 To be relevant, financial information must be able to influence the economic decisions of users. **Timeliness** involves providing the information within the decision time frame. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the needs of users in making economic decisions.

Balance between benefit and cost

2.13 The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users.

2.14 Financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. Individual entities also enjoy benefits, including improved access to capital markets, favourable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes.

Undue cost or effort

2.14A An undue cost or effort exemption is specified for some requirements in this Standard. This exemption shall not be used for other requirements in this Standard.

2.14B Considering whether obtaining or determining the information necessary to comply with a requirement would involve undue cost or effort depends on the entity's specific circumstances and on management's judgement of the costs and benefits from applying that requirement. This judgement requires consideration of how the economic decisions of those that are expected to use the financial statements could be affected by not having that information. Applying a requirement would involve undue cost or effort by a private entity if the incremental cost (for example, valuers' fees) or additional effort (for example, endeavours by employees) substantially exceed the benefits that those that are expected to use the private entity's financial statements would receive from having the information. An assessment of undue cost or effort by a private entity in accordance with this Standard would usually constitute a lower hurdle than an assessment of undue cost or effort by a publicly accountable entity because private entities are not accountable to public stakeholders.

2.14C Assessing whether a requirement would involve undue cost or effort on initial **recognition** in the financial statements, for example at the date of the transaction, should be based on information about the costs and benefits of the requirement at the time of initial recognition. If the undue cost or effort exemption also applies subsequent to initial recognition, for example to a subsequent measurement of an item, a new assessment of undue cost or effort should be made at that subsequent date, based on information available at that date.

2.14D Except for the undue cost or effort exemption in paragraph 19.15, which is covered by the disclosure requirements in paragraph 19.25, whenever an undue cost or effort exemption is used by an entity, the entity shall disclose that fact and the reasons why applying the requirement would involve undue cost or effort.

Financial position

2.15 The financial position of an entity is the relationship of its assets, liabilities and **equity** as of a specific date as presented in the **statement of financial position**. These are defined as follows:

(a) 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;

(b) 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; and

(c) equity is the residual interest in the assets of the entity after deducting all its liabilities.

2.16 Some items that meet the definition of an asset or a liability may not be recognised as assets or liabilities in the statement of financial position because they do not satisfy the criteria for recognition in paragraphs 2.27–2.32. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognised.

Assets

2.17 The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of **cash** and **cash equivalents** to the entity. Those cash flows may come from using the asset or from disposing of it.

2.18 Many assets, for example **property, plant and equipment**, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible.

2.19 In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a **lease** is an asset if the entity controls the benefits that are expected to flow from the property.

Liabilities

2.20 An essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a **constructive obligation**. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from an entity's actions when:

(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.

2.21 The settlement of a present obligation usually involves the payment of cash, the transfer of other assets, the provision of services, the replacement of that obligation with another obligation or the conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

2.22 Equity is the residual of recognised assets minus recognised liabilities. It may be subclassified in the statement of financial position. For example, in a corporate entity, subclassifications may include funds contributed by shareholders, retained earnings and items of **other comprehensive income** recognised as a separate component of equity. This Standard does not prescribe how, when or if amounts can be transferred between components of equity.

Performance

2.23 Performance is the relationship of the income and expenses of an entity during a **reporting period**. This Standard permits entities to present performance in a single financial statement (a **statement of comprehensive income**) or in two financial statements (an **income statement** and a statement of comprehensive income). **Total comprehensive income** and **profit or loss** are frequently used as measures of performance or as the basis for other measures, such as return on investment or earnings per share. Income and expenses are defined as follows:

(a) income is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from **owners**; and.

(b) expenses are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to owners.

2.24 The recognition of income and expenses results directly from the recognition and measurement of assets and liabilities. Criteria for the recognition of income and expenses are discussed in paragraphs 2.27–2.32.

Income

2.25 The definition of income encompasses both **revenue** and **gains**.

(a) revenue is income that arises in the course of the ordinary activities of an entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties and rent.

(b) gains are other items that meet the definition of income but are not revenue. When gains are recognised in the statement of comprehensive income, they are usually displayed separately because knowledge of them is useful for making economic decisions.

Expenses

2.26 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity:

(a) expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and **depreciation**. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, **inventory**, or property, plant and equipment.

(b) **losses** are other items that meet the definition of expenses and may arise in the course of the ordinary activities of the entity. When losses are recognised in the statement of comprehensive income, they are usually presented separately because knowledge of them is useful for making economic decisions.

Recognition of assets, liabilities, income and expenses

2.27 Recognition is the process of incorporating in the financial statements an item that meets the definition of an asset, liability, income or expense and satisfies the following criteria:

(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 reliably.

2.28 The failure to recognise an item that satisfies those criteria is not rectified by disclosure of the accounting policies used or by **notes** or explanatory material.

The probability of future economic benefit

2.29 The concept of probability is used in the first recognition criterion to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items.

Reliability of measurement

2.30 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the financial statements.

2.31 An item that fails to meet the recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events.

2.32 An item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

Measurement of assets, liabilities, income and expenses

2.33 Measurement is the process of determining the monetary amounts at which an entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. This Standard specifies which measurement basis an entity shall use for many types of assets, liabilities, income and expenses.

2.34 Two common measurement bases are historical cost and **fair value**:

(a) for assets, historical cost is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition. For liabilities, historical cost is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred, or in some circumstances (for example, **income tax**) the amounts of cash or cash equivalents expected to be paid to settle the liability in the normal course of business. Amortised historical cost is the historical cost of an asset or liability plus or minus that portion of its historical cost previously recognised as expense or income.

(b) fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. In situations in which fair value measurement is permitted or required, the guidance in paragraphs 11.27-11.32 shall be applied.

Pervasive recognition and measurement principles

2.35 The requirements for recognising and measuring assets, liabilities, income and expenses in this Standard are based on pervasive principles that are derived from **full HKFRSs**. In the absence of a requirement in this Standard that applies specifically to a transaction or other event or condition, paragraph 10.4 provides guidance for making a judgement and paragraph 10.5 establishes a hierarchy for an entity to follow in deciding on the appropriate accounting policy in the circumstances. The second level of that hierarchy requires an entity to look to the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles set out in this section.

Accrual basis

2.36 An entity shall prepare its financial statements, except for cash flow information, using the **accrual basis of accounting.** On the accrual basis, items are recognised as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items.

Recognition in financial statements

Assets

2.37 An entity shall recognise an asset in the statement of financial position when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. An asset is not recognised in the statement of financial position when expenditure has been incurred for which it is considered not probable that economic benefits will flow to the entity beyond the current reporting period. Instead such a transaction results in the recognition of an expense in the statement of comprehensive income (or in the income statement, if presented).

2.38 An entity shall not recognise a **contingent asset** as an asset. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

Liabilities

2.39 An entity shall recognise a liability in the statement of financial position when

(a) the entity has an obligation at the end of the reporting period as a result of a past event;

(b) it is probable that the entity will be required to transfer resources embodying economic benefits in settlement;and

(c) the settlement amount can be measured reliably.

2.40 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 2.39. An entity shall not recognise a contingent liability as a liability, except for contingent liabilities of an acquiree in a **business combination** (see Section 19 *Business Combinations and Goodwill*).

Income

2.41 The recognition of income results directly from the recognition and measurement of assets and liabilities. An entity shall recognise income in the statement of comprehensive income (or in the income statement, if presented) when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Expenses

2.42 The recognition of expenses results directly from the recognition and measurement of assets and liabilities. An entity shall recognise expenses in the statement of comprehensive income (or in the income statement, if presented) when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

Total comprehensive income and profit or loss

2.43 Total comprehensive income is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.

2.44 Profit or loss is the arithmetical difference between income and expenses other than those items of income and expense that this Standard classifies as items of other comprehensive income. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.

2.45 This Standard does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the ‘matching concept’ for measuring profit or loss.

Measurement at initial recognition

2.46 At initial recognition, an entity shall measure assets and liabilities at historical cost unless this Standard requires initial measurement on another basis such as fair value.

Subsequent measurement

Financial assets and financial liabilities

2.47 An entity measures basic **financial assets** and basic **financial liabilities**, as defined in Section 11 *Basic Financial Instruments*, at amortised cost less **impairment** except for investments in non-convertible preference shares and non-puttable ordinary or preference shares that are **publicly traded** or whose fair value can otherwise be measured reliably without undue cost or effort, which are measured at fair value with changes in fair value recognised in profit or loss.

2.48 An entity generally measures all other financial assets and financial liabilities at fair value, with changes in fair value recognised in profit or loss, unless this Standard requires or permits measurement on another basis such as cost or amortised cost.

Non-financial assets

2.49 Most non-financial assets that an entity initially recognised at historical cost are subsequently measured on other measurement bases. For example:

(a) an entity measures property, plant and equipment either at the lower of cost less any accumulated depreciation and impairment and the **recoverable amount** (cost model) or the lower of the revalued amount and the recoverable amount (revaluation model);

(b) an entity measures inventories at the lower of cost and selling price less costs to complete and sell; and

(c) an entity recognises an impairment loss relating to non-financial assets that are in use or held for sale.

Measurement of assets at those lower amounts is intended to ensure that an asset is not measured at an amount greater than the entity expects to recover from the sale or use of that asset.

2.50 For the following types of non-financial assets, this Standard permits or requires measurement at fair value:

(a) investments in **associates** and **joint ventures** that an entity measures at fair value (see paragraphs 14.10 and 15.15 respectively);

(b) **investment property** that an entity measures at fair value (see paragraph 16.7);

(c) agricultural assets (**biological assets** and **agricultural produce** at the point of harvest) that an entity measures at fair value less estimated costs to sell (see paragraph 34.2); and

(d) property, plant and equipment that an entity measures in accordance with the revaluation model (see paragraph 17.15B).

Liabilities other than financial liabilities

2.51 Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the **reporting date**.

Offsetting

2.52 An entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by this Standard.

(a) measuring assets net of valuation allowances is not offsetting. For example, allowances for inventory obsolescence and allowances for uncollectible receivables.

(b) if an entity's normal operating activities do not include buying and selling non-current assets, including investments and operating assets, then the entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the **carrying amount** of the asset and related selling expenses.

Section 3
Financial Statement Presentation

Scope of this section

3.1 This section explains **true and fair view** of **financial statements**, what compliance with the *HKFRS for Private Entities* requires, and what a complete set of financial statements is.

True and fair view

3.2 Financial statements shall present a true and fair view of the **financial position**, financial **performance** and **cash flows** of an entity. True and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and **recognition** criteria for **assets**, **liabilities**, **income** and **expenses** set out in Section 2 *Concepts and Pervasive Principles*.

(a) the application of the *HKFRS for Private Entities*, with additional disclosure when necessary, is presumed to result in financial statements that achieve a true and fair view of the financial position, financial performance and cash flows of Private Entities.

(b) as explained in paragraph 1.5, the application of this Standard by an entity with **public accountability** does not result in a true and fair view in accordance with this Standard.

The additional disclosures referred to in (a) are necessary when compliance with the specific requirements in this Standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance.

Compliance with the *HKFRS for Private Entities*

3.3 An entity whose financial statements comply with the *HKFRS for Private Entities* shall make an explicit and unreserved statement of such compliance in the **notes**. Financial statements shall not be described as complying with the *HKFRS for Private Entities* unless they comply with all the requirements of this Standard.

3.4 In the extremely rare circumstances when management concludes that compliance with this Standard would be so misleading that it would conflict with the **objective of financial statements** of Private Entities set out in Section 2, the entity shall depart from that requirement in the manner set out in paragraph 3.5 unless the relevant regulatory framework prohibits such a departure.

3.5 When an entity departs from a requirement of this Standard in accordance with paragraph 3.4, it shall disclose the following:

(a) that management has concluded that the financial statements present a true and fair view of the entity's financial position, financial performance and cash flows;

(b) that it has complied with the *HKFRS for Private Entities*, except that it has departed from a particular requirement to achieve a true and fair view; and

(c) the nature of the departure, including the treatment that the *HKFRS for Private Entities* would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2, and the treatment adopted.

3.6 When an entity has departed from a requirement of this Standard in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.5(c).

3.7 In the extremely rare circumstances when management concludes that compliance with a requirement in this Standard would be so misleading that it would conflict with the objective of financial statements of Private Entities set out in Section 2, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing the following:

(a) the nature of the requirement in this Standard, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in Section 2; and

(b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a true and fair view.

Going concern

3.8 When preparing financial statements, the management of an entity using this Standard shall make an assessment of the entity's ability to continue as a **going concern**. An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the **reporting date**.

3.9 When management is aware, in making its assessment, of **material** uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Frequency of reporting

3.10 An entity shall present a complete set of financial statements (including comparative information–see paragraph 3.14) at least annually. When the end of an entity's **reporting period** changes and the annual financial statements are presented for a period longer or shorter than one year, the entity shall disclose the following:

(a) that fact;

(b) the reason for using a longer or shorter period; and

(c) the fact that comparative amounts presented in the financial statements (including the related notes) are not entirely comparable.

Consistency of presentation

3.11 An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

(a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of **accounting policies** in Section 10 *Accounting Policies, Estimates and Errors*; or

(b) this Standard requires a change in presentation.

3.12 When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is **impracticable**. When comparative amounts are reclassified, an entity shall disclose the following:

(a) the nature of the reclassification;

(b) the amount of each item or class of items that is reclassified; and

(c) the reason for the reclassification.

3.13 If it is impracticable to reclassify comparative amounts, an entity shall disclose why reclassification was not practicable.

Comparative information

3.14 Except when this Standard permits or requires otherwise, an entity shall disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Materiality and aggregation

3.15 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

3.16 Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Complete set of financial statements

3.17 A complete set of financial statements of an entity shall include all of the following:

(a) a **statement of financial position** as at the reporting date;

(b) either:

(i) a single **statement of comprehensive income** for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining **profit or loss** (which is a subtotal in the statement of comprehensive income) and items of **other comprehensive income**.

(ii) a separate **income statement** and a separate statement of comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.

(c) a **statement of changes in equity** for the reporting period;

(d) a **statement of cash flows** for the reporting period; and

(e) notes, comprising a summary of significant accounting policies and other explanatory information.

3.18 If the only changes to equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period **errors**, and changes in accounting policy, the entity may present a single **statement of income and retained earnings** in place of the statement of comprehensive income and statement of changes in equity (see paragraph 6.4).

3.19 If an entity has no items of other comprehensive income in any of the periods for which financial statements are presented, it may present only an income statement, or it may present a statement of comprehensive income in which the 'bottom line' is labelled 'profit or loss'.

3.20 Because paragraph 3.14 requires comparative amounts in respect of the previous period for all amounts presented in the financial statements, a complete set of financial statements means that an entity shall present, as a minimum, two of each of the required financial statements and related notes.

3.21 In a complete set of financial statements, an entity shall present each financial statement with equal prominence.

3.22 An entity may use titles for the financial statements other than those used in this Standard as long as they are not misleading.

Identification of the financial statements

3.23 An entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. In addition, an entity shall display the following information prominently and repeat it when necessary for an understanding of the information presented:

(a) the name of the reporting entity and any change in its name since the end of the preceding reporting period;

(b) whether the financial statements cover the individual entity or a **group** of entities;

(c) the date of the end of the reporting period and the period covered by the financial statements;

(d) the **presentation currency**, as defined in Section 30 *Foreign Currency Translation*; and

(e) the level of rounding, if any, used in presenting amounts in the financial statements.

3.24 An entity shall disclose the following in the notes:

(a) the domicile and legal form of the entity, its country of incorporation and the address of its 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.

Presentation of information not required by this Standard

3.25 This Standard does not address presentation of segment information, earnings per share, or interim financial reports by a private entity. An entity making such disclosures shall describe the basis for preparing and presenting the information.

Section 4
Statement of Financial Position

Scope of this section

4.1 This section sets out the information that is to be presented in a **statement of financial position** and how to present it. The statement of financial position (sometimes called the balance sheet) presents an entity's **assets, liabilities** and **equity** as of a specific date—the end of the **reporting period**.

Information to be presented in the statement of financial position

4.2 As a minimum, the statement of financial position shall include line items that present the following amounts:

(a) **cash** and **cash equivalents**;

(b) trade and other receivables;

(c) **financial assets** (excluding amounts shown under (a), (b), (j) and (k));

(d) **inventories**;

(e) **property, plant and equipment**;

(ea) **investment property** carried at cost less accumulated **depreciation** and **impairment**;

(f) investment property carried at **fair value** through **profit or loss**;

(g) **intangible assets**;

(h) **biological assets** carried at cost less accumulated depreciation and impairment;

(i) biological assets carried at fair value through profit or loss;

(j) investments in **associates**;

(k) investments in **jointly controlled entities**;

(l) trade and other payables;

(m) **financial liabilities** (excluding amounts shown under (l) and (p));

(n) liabilities and assets for **current tax**;

(o) **deferred tax liabilities** and **deferred tax assets** (these shall always be classified as non-current);

(p) **provisions**;

(q) **non-controlling interest**, presented within equity separately from the equity attributable to the **owners** of the **parent**; and

(r) equity attributable to the owners of the parent.

4.3 An entity shall present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's **financial position**.

Current/non-current distinction

4.4 An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 4.5–4.8, except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity (ascending or descending).

Current assets

4.5 An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in the entity's normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the **reporting date**; or

(d) the asset is cash or a cash equivalent, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

4.6 An entity shall classify all other assets as non-current. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

Current liabilities

4.7 An entity shall classify a liability as current when:

(a) it expects to settle the liability in the entity's normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting date; or

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

4.8 An entity shall classify all other liabilities as non-current.

Sequencing of items and format of items in the statement of financial position

4.9 This Standard does not prescribe the sequence or format in which items are to be presented. Paragraph 4.2 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

(a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and

(b) the descriptions used and the sequencing of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position.

4.10 The judgement on whether additional items are presented separately is based on an assessment of all of the following:

(a) the amounts, nature and liquidity of assets;

(b) the function of assets within the entity; and

(c) the amounts, nature and timing of liabilities.

[1] The classification of a term loan as a current or non-current liability in accordance with paragraph 4.7(d) shall 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 reporting date. In this regard, the probability of the lender choosing to exercise its right within the next twelve months after the reporting date is not relevant.

The classification of a term loan in accordance with paragraph 4.7(d) shall depend on whether or not the borrower has an unconditional right to defer payment for at least twelve months after the reporting period. 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 shall 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 reporting 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".

Information to be presented either in the statement of financial position or in the notes

4.11 An entity shall disclose, either in the statement of financial position or in the **notes**, the following subclassifications of the line items presented:

(a) property, plant and equipment in classifications appropriate to the entity;

(b) trade and other receivables showing separately amounts due from related parties, amounts due from other parties, and receivables arising from accrued **income** not yet billed;

(c) inventories, showing separately amounts of inventories:

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

(ii) in the process of production for such sale; and

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

(d) trade and other payables, showing separately amounts payable to trade suppliers, payable to related parties, deferred income and accruals;

(e) provisions for **employee benefits** and other provisions; and

(f) classes of equity, such as paid-in capital, share premium, retained earnings and items of income and **expense** that, as required by this Standard, are recognised in **other comprehensive income** and presented separately in equity.

4.12 An entity with share capital shall disclose the following, either in the statement of financial position 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. This reconciliation need not be presented for prior periods.

(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 or by its **subsidiaries** or associates.

(vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts.

(b) a description of each reserve within equity.

4.13 An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.12(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.

4.14 If, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a group of assets and liabilities, the entity shall disclose the following information:

(a) a description of the asset(s) or the group of assets and liabilities;

(b) a description of the facts and circumstances of the sale or plan; and

(c) the **carrying amount** of the assets or, if the disposal involves a group of assets and liabilities, the carrying amounts of those assets and liabilities.

Section 5
Statement of Comprehensive Income and Income Statement

Scope of this section

5.1 This section requires an entity to present its **total comprehensive income** for a period—ie its financial **performance** for the period—in one or two **financial statements**. It sets out the information that is to be presented in those statements and how to present it.

Presentation of total comprehensive income

5.2 An entity shall present its total comprehensive income for a period either:

(a) in a single **statement of comprehensive income**, in which case the statement of comprehensive income presents all items of **income** and **expense** recognised in the period; or

(b) in two statements—an **income statement** and a statement of comprehensive income—in which case the income statement presents all items of income and expense recognised in the period except those that are recognised in total comprehensive income outside of **profit or loss** as permitted or required by this Standard.

5.3 A change from the single-statement approach to the two-statement approach, or vice versa, is a change in accounting policy to which Section 10 *Accounting Policies, Estimates and Errors* applies.

Single-statement approach

5.4 Under the single-statement approach, the statement of comprehensive income shall include all items of income and expense recognised in a period unless this Standard requires otherwise. This Standard provides different treatment for the following circumstances:

(a) the effects of corrections of **errors** and changes in **accounting policies** are presented as retrospective adjustments of prior periods instead of as part of profit or loss in the period in which they arise (see Section 10); and

(b) four types of **other comprehensive income** are recognised as part of total comprehensive income, outside of profit or loss, when they arise:

(i) some **gains** and **losses** arising on translating the financial statements of a **foreign operation** (see Section 30 *Foreign Currency Translation*);

(ii) some actuarial gains and losses (see Section 28 *Employee Benefits*);

(iii) some changes in **fair values** of **hedging instruments** (see Section 12 *Other Financial Instrument Issues*); and

(iv) changes in the revaluation surplus for **property, plant and equipment** measured in accordance with the revaluation model (see Section 17 *Property, Plant and Equipment*).

5.5 As a minimum, an entity shall include, in the statement of comprehensive income, line items that present the following amounts for the period:

(a) **revenue**.

(b) finance costs.

(c) share of the profit or loss of investments in **associates** (see Section 14 *Investments in Associates*) and **jointly controlled entities** (see Section 15 *Investments in Joint Ventures*) accounted for using the equity method.

(d) **tax expense** excluding tax allocated to items (e), (g) and (h) (see paragraph 29.35).

(e) a single amount comprising the total of:

(i) the post-tax profit or loss of a **discontinued operation**; and

(ii) the post-tax gain or loss attributable to an **impairment**, or reversal of an impairment, of the **assets** in the discontinued operation (see Section 27 *Impairment of Assets*), both at the time and subsequent to being classified as a discontinued operation and to the disposal of the net assets constituting the discontinued operation.

(f) profit or loss (if an entity has no items of other comprehensive income, this line need not be presented).

(g) each item of other comprehensive income (see paragraph 5.4(b)) classified by nature (excluding amounts in (h)). Such items shall be grouped into those that, in accordance with this Standard:

(i) will not be reclassified subsequently to profit or loss—ie those in paragraph 5.4(b)(i)–(ii) and (iv); and

(ii) will be reclassified subsequently to profit or loss when specific conditions are met—ie those in paragraph 5.4(b)(iii).

(h) share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method.

(i) total comprehensive income (if an entity has no items of other comprehensive income,it may use another term for this line such as profit or loss).

5.6 An entity shall disclose separately the following items in the statement of comprehensive income as allocations for the period:

(a) profit or loss for the period attributable to

(i) **non-controlling interest**; and

(ii) **owners** of the **parent**.

(b) total comprehensive income for the period attributable to

(i) non-controlling interest; and

(ii) owners of the parent.

Two-statement approach

5.7 Under the two-statement approach, the income statement shall display, as a minimum, line items that present the amounts in paragraph 5.5(a)–5.5(f) for the period, with profit or loss as the last line. The statement of comprehensive income shall begin with profit or loss as its first line and shall display, as a minimum, line items that present the amounts in paragraph 5.5(g)–5.5(i) and paragraph 5.6 for the period.

Requirements applicable to both approaches

5.8 Under this Standard, the effects of corrections of errors and changes in accounting policies are presented as retrospective adjustments of prior periods instead of as part of profit or loss in the period in which they arise (see Section 10).

5.9 An entity shall present additional line items, headings and subtotals in the statement of comprehensive income (and in the income statement, if presented), when such presentation is relevant to an understanding of the entity's financial performance.

5.10 An entity shall not present or describe any items of income and expense as 'extraordinary items' in the statement of comprehensive income (or in the income statement, if presented) or in the **notes**.

Analysis of expenses

5.11 An entity shall present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant.

Analysis by nature of expense

(a) Under this method of classification, expenses are aggregated in the statement of comprehensive income according to their nature (for example, **depreciation**, purchases of materials, transport costs, **employee benefits** and advertising costs) and are not reallocated among various functions within the entity.

Analysis by function of expense

(b) Under this method of classification, expenses are aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

Section 6
Statement of Changes in Equity and Statement of Income and Retained Earnings

Scope of this section

6.1 This section sets out requirements for presenting the changes in an entity's **equity** for a period, either in a **statement of changes in equity** or, if specified conditions are met and an entity chooses, in a **statement of income and retained earnings**.

Statement of changes in equity

Purpose

6.2 The statement of changes in equity presents an entity's **profit or loss** for a **reporting period**, **other comprehensive income** for the period, the effects of changes in **accounting policies** and corrections of **errors** recognised in the period and the amounts of investments by, and dividends and other distributions to, **owners** in their capacity as owners during the period.

Information to be presented in the statement of changes in equity

6.3 The statement of changes in equity includes the following information:

(a) **total comprehensive income** for the period, showing separately the total amounts attributable to owners of the **parent** and to **non-controlling interests**;

(b) for each component of equity, the effects of **retrospective application** or retrospective restatement recognised in accordance with Section 10 *Accounting Policies, Estimates and Errors*; and

(c) for each component of equity, a reconciliation between the **carrying amount** at the beginning and the end of the period, separately disclosing changes resulting from:

(i) profit or loss;

(ii) other comprehensive income; and

(iii) the amounts of investments by, and dividends and other distributions to, owners in their capacity as owners, showing separately issues of shares, **treasury share** transactions, dividends and other distributions to owners, and changes in ownership interests in **subsidiaries** that do not result in a loss of **control**.

Statement of income and retained earnings

Purpose

6.4 The statement of income and retained earnings presents an entity's profit or loss and changes in retained earnings for a reporting period. Paragraph 3.18 permits an entity to present a statement of income and retained earnings in place of a **statement of comprehensive income** and a statement of changes in equity if the only changes to its equity during the periods for which **financial statements** are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy.

Information to be presented in the statement of income and retained earnings

6.5 An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by Section 5 *Statement of Comprehensive Income and Income Statement*:

(a) retained earnings at the beginning of the reporting period;

(b) dividends declared and paid or payable during the period;

(c) restatements of retained earnings for corrections of prior period errors;

(d) restatements of retained earnings for changes in accounting policy; and

(e) retained earnings at the end of the reporting period.

Section 7
Statement of Cash Flows

Scope of this section

7.1 This section sets out the information that is to be presented in a **statement of cash flows** and how to present it. The statement of cash flows provides information about the changes in **cash** and **cash equivalents** of an entity for a **reporting period**, showing separately changes from **operating activities, investing activities** and **financing activities**.

Cash equivalents

7.2 Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. They are held to meet short-term cash commitments instead of for investment or other purposes. Consequently, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

Information to be presented in the statement of cash flows

7.3 An entity shall present a statement of cash flows that presents **cash flows** for a reporting period classified by operating activities, investing activities and financing activities.

Operating activities

7.4 Operating activities are the principal revenue-producing activities of the entity. Consequently, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of **profit or loss**. Examples of cash flows from operating activities are:

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

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

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

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

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

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

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

Investing activities

7.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:

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

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

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

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

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

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

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge (see Section 12 *Other Financial Instrument Issues*), an entity shall classify the cash flows of the contract in the same manner as the cash flows of the item being hedged.

Financing activities

7.6 Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of an entity. Examples of cash flows arising from financing activities are:

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

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

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

(d) cash repayments of amounts borrowed; and

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

Reporting cash flows from operating activities

7.7 An entity shall present cash flows from operating activities using either:

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

(b) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.

Indirect method

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

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

(b) non-cash items such as **depreciation, provisions, deferred tax**, accrued income (expenses) not yet received (paid) in cash, unrealised foreign currency gains and losses, undistributed profits of **associates**, and **non-controlling interests**; and

(c) all other items for which the cash effects relate to investing or financing.

Direct method

7.9 Under the direct method, net cash flow from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:

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

(b) by adjusting sales, cost of sales and other items in the **statement of comprehensive income** (or the **income statement**, if presented) for:

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

(ii) other non-cash items; and

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

Reporting cash flows from investing and financing activities

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

Foreign currency cash flows

7.11 An entity shall record cash flows arising from transactions in a foreign currency in the entity's **functional currency** by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow. Paragraph 30.19 explains when an exchange rate that approximates the actual rate can be used.

7.12 The entity shall translate cash flows of a foreign subsidiary at the exchange rates between the entity's functional currency and the foreign currency at the dates of the cash flows.

7.13 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be presented in the statement of cash flows. Consequently, the entity shall remeasure cash and cash equivalents held during the reporting period (such as amounts of foreign currency held and foreign currency bank accounts) at period-end exchange rates. The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

Interest and dividends

7.14 An entity shall present separately cash flows from interest and dividends received and paid. The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.

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

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

Income tax

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

Non-cash transactions

7.18 An entity shall exclude from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the **financial statements** in a way that provides all the relevant information about those investing and financing activities.

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

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

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

(c) the conversion of debt to equity.

Components of cash and cash equivalents

7.20 An entity shall present the components of cash and cash equivalents and shall present a reconciliation of the amounts presented in the statement of cash flows to the equivalent items presented in the **statement of financial position**. However, an entity is not required to present this reconciliation if the amount of cash and cash equivalents presented in the statement of cash flows is identical to the amount similarly described in the statement of financial position.

Other disclosures

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

Section 8
Notes to the Financial Statements

Scope of this section

8.1 This section sets out the principles underlying information that is to be presented in the **notes** to the **financial statements** and how to present it. Notes contain information in addition to that presented in the **statement of financial position,** the **statement of comprehensive income** (if presented), the **income statement** (if presented), the combined **statement of income and retained earnings** (if presented), the **statement of changes in equity** (if presented), and the **statement of cash flows**. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for **recognition** in those statements. In addition to the requirements of this section, nearly every other section of this Standard requires disclosures that are normally presented in the notes.

Structure of the notes

8.2 The notes shall:

(a) present information about the basis of preparation of the financial statements and the specific **accounting policies** used, in accordance with paragraphs 8.5–8.7;

(b) disclose the information required by this Standard that is not presented elsewhere in the financial statements; and

(c) provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.

8.3 An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.

8.4 An entity normally presents the notes in the following order:

(a) a statement that the financial statements have been prepared in compliance with the *HKFRS for Private Entities* (see paragraph 3.3);

(b) a summary of significant accounting policies applied (see paragraph 8.5);

(c) supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and

(d) any other disclosures.

Disclosure of accounting policies

8.5 An entity shall disclose the following in the summary of significant accounting policies:

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

(b) the other accounting policies used that are relevant to an understanding of the financial statements.

Information about judgements

8.6 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Information about key sources of estimation uncertainty

8.7 An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the **reporting date**, that have a significant risk of causing a **material** adjustment to the **carrying amounts** of **assets** and **liabilities** within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature; and

(b) their carrying amount as at the end of the **reporting period**.

Section 9
Consolidated and Separate Financial Statements

Scope of this section

9.1 This section defines the circumstances in which an entity applying this Standard presents **consolidated financial statements** and the procedures for preparing those statements in accordance with this Standard. It also includes guidance on **separate financial statements** and **combined financial statements** if they are prepared in accordance with this Standard. If a **parent** entity by itself does not have **public accountability**, it may present its separate financial statements in accordance with this Standard, even if it presents its consolidated financial statements in accordance with **full HKFRSs** or another set of generally accepted accounting principles (GAAP).

Requirement to present consolidated financial statements

9.2 Except as permitted or required by paragraphs 9.3 and 9.3C, a parent entity shall present consolidated financial statements in which it consolidates its investments in **subsidiaries**. Consolidated financial statements shall include all subsidiaries of the parent.

9.3 A parent need not present consolidated financial statements if both of the following conditions are met:

(a) the parent is itself a subsidiary; and

(b) its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with full HKFRSs, IFRSs, this Standard or the IFRS for SMEs issued by the IASB.

9.3A Subject to paragraph 9.3B, a subsidiary is not consolidated if it is acquired and is held with the intention of selling or disposing of it within one year from its acquisition date (ie the date on which the acquirer obtains **control** of the acquiree). Such a subsidiary is accounted for in accordance with the requirements in Section 11 *Basic Financial Instruments* as for investments in paragraph 11.8(d), instead of in accordance with this section. The parent shall also provide the disclosure in paragraph 9.23A.

9.3B If a subsidiary previously excluded from consolidation in accordance with paragraph 9.3A is not disposed of within one year from its acquisition date (ie the parent entity still has control over that subsidiary):

(a) the parent shall consolidate the subsidiary from the acquisition date unless it meets the condition in paragraph 9.3B(b). Consequently, if the acquisition date was in a prior period, the relevant prior periods shall be restated.

(b) if the delay is caused by events or circumstances beyond the parent's control and there is sufficient evidence at the **reporting date** that the parent remains committed to its plan to sell or dispose of the subsidiary, the parent shall continue to account for the subsidiary in accordance with paragraph 9.3A.

9.3C If a parent has no subsidiaries other than subsidiaries that are not required to be consolidated in accordance with paragraphs 9.3A–9.3B, it shall not present consolidated financial statements. However, the parent shall provide the disclosure in paragraph 9.23A.

9.4 A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. If an entity has created a special purpose entity (SPE) to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity (see paragraphs 9.10–9.12).

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

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

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

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

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

9.6 Control can also be achieved by having options or convertible instruments that are currently exercisable or by having an agent with the ability to direct the activities for the benefit of the controlling entity.

9.7 A subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation or similar entity.

9.8 A subsidiary is not excluded from consolidation because its business activities are dissimilar to those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.

9.9 A subsidiary is not excluded from consolidation because it operates in a jurisdiction that imposes restrictions on transferring **cash** or other **assets** out of the jurisdiction.

Special purpose entities

9.10 An entity may be created to accomplish a narrow objective (for example, to effect a **lease**, undertake **research** and **development** activities or securitise **financial assets**). Such an SPE may take the form of a corporation, trust, partnership or unincorporated entity. Often, SPEs are created with legal arrangements that impose strict requirements over the operations of the SPE.

9.11 An entity shall prepare consolidated financial statements that include the entity and any SPEs that are controlled by that entity. In addition to the circumstances described in paragraph 9.5, the following circumstances may indicate that an entity controls an SPE (this is not an exhaustive list):

(a) the activities of the SPE are being conducted on behalf of the entity according to its specific business needs;

(b) the entity has the ultimate decision-making powers over the activities of the SPE even if the day-to-day decisions have been delegated;

(c) the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or

(d) the entity retains the majority of the residual or ownership risks related to the SPE or its assets.

9.12 Paragraphs 9.10 and 9.11 do not apply to **post-employment benefit plans** or other long-term **employee benefit** plans to which Section 28 *Employee Benefits* applies.

Consolidation procedures

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

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

(b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.

(c) measure and present **non-controlling interest** in the **profit or loss** of consolidated subsidiaries for the **reporting period** separately from the interest of the **owners** of the parent.

(d) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interest in the net assets consists of:

(i) the amount of the non-controlling interest at the date of the original combination calculated in accordance with Section 19 *Business Combinations and Goodwill*; and

(ii) the non-controlling interest's share of changes in equity since the date of the combination.

9.14 The proportions of profit or loss and changes in equity allocated to the owners of the parent and to the non-controlling interest are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of options or convertible instruments.

Intragroup balances and transactions

9.15 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as **inventory** and **property, plant and equipment**, are eliminated in full. Intragroup losses may indicate an **impairment** that requires **recognition** in the consolidated financial statements (see Section 27 *Impairment of Assets*). Section 29 *Income Tax* applies to **temporary differences** that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform reporting date

9.16 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date unless it is **impracticable** to do so. If it is impracticable to prepare the financial statements of a subsidiary as of the same reporting date as the parent, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

Uniform accounting policies

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

Acquisition and disposal of subsidiaries

9.18 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date until the date on which the parent ceases to control the subsidiary. When a parent ceases to control a subsidiary, the difference between the proceeds from the disposal of the subsidiary and its carrying amount at the date that control is lost is recognised in profit or loss in the consolidated **statement of comprehensive income** (or the **income statement**, if presented) as the **gain** or loss on the disposal of the subsidiary. The cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in **other comprehensive income** in accordance with Section 30 *Foreign Currency Translation* is not reclassified to profit or loss on disposal of the subsidiary.

9.19 If an entity ceases to be a subsidiary but the investor (former parent) continues to hold an investment in the former subsidiary, that investment shall be accounted for as a financial asset in accordance with Section 11 or Section 12 *Other Financial Instrument Issues* from the date the entity ceases to be a subsidiary, provided that it does not become an **associate** (in which case Section 14 *Investments in Associates* applies) or a **jointly controlled entity** (in which case Section 15 *Investments in Joint Ventures* applies). The carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial **measurement** of the financial asset.

Non-controlling interest in subsidiaries

9.20 An entity shall present non-controlling interest in the consolidated **statement of financial position** within equity, separately from the equity of the owners of the parent, as required by paragraph 4.2(q).

9.21 An entity shall disclose non-controlling interest in the profit or loss of the group separately in the statement of comprehensive income, as required by paragraph 5.6 (or in the income statement, if presented, as required by paragraph 5.7).

9.22 Profit or loss and each component of other comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest. **Total comprehensive income** shall be attributed to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interest having a deficit balance.

Disclosures in consolidated financial statements

9.23 The following disclosures shall be made in consolidated financial statements:

(a) the fact that the statements are consolidated financial statements;

(b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;

(c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements; and

(d) the nature and extent of any significant restrictions (for example resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.

9.23A In addition to the disclosure requirements in Section 11, a parent entity shall disclose the carrying amount of investments in subsidiaries that are not consolidated (see paragraphs 9.3A–9.3C) at the reporting date, in total, either in the statement of financial position or in the **notes**.

Separate financial statements

Presentation of separate financial statements

9.24 This Standard does not require presentation of separate financial statements for the parent entity or for the individual subsidiaries.

9.25 Separate financial statements are a second set of financial statements presented by an entity in addition to any of the following:

(a) consolidated financial statements prepared by a parent;

(b) financial statements prepared by a parent exempted from preparing consolidated financial statements by paragraph 9.3C; or

(c) financial statements prepared by an entity that is not a parent but is an investor in an associate or has a **venturer**'s interest in a **joint venture**.

Accounting policy election

9.26 When a parent, an investor in an associate or a venturer with an interest in a jointly controlled entity prepares separate financial statements and describes them as conforming to the *HKFRS for Private Entities*, those statements shall comply with all of the requirements of this Standard except as follows. The entity shall adopt a policy of accounting for its investments in subsidiaries, associates and **jointly controlled entities** in its separate financial statements either:

(a) at cost less impairment;

(b) at **fair value** with changes in fair value recognised in profit or loss; or

(c) using the equity method following the procedures in paragraph 14.8.

The entity shall apply the same accounting policy for all investments in a single class (subsidiaries, associates or jointly controlled entities), but it can elect different policies for different classes.

Disclosures in separate financial statements

9.27 When a parent, an investor in an associate or a venturer with an interest in a jointly controlled entity prepares separate financial statements, those separate financial statements shall disclose:

(a) that the statements are separate financial statements; and

(b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates,

and shall identify the consolidated financial statements or other primary financial statements

to which they relate.

Combined financial statements

9.28 Combined financial statements are a single set of financial statements of two or more entities under common control (as described in paragraph 19.2(a)). This Standard does not require combined financial statements to be prepared.

9.29 If the investor prepares combined financial statements and describes them as conforming to the *HKFRS for Private Entities*, those statements shall comply with all of the requirements of this Standard. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and property, plant and equipment shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances.

Disclosures in combined financial statements

9.30 The combined financial statements shall disclose the following:

(a) the fact that the financial statements are combined financial statements;

(b) the reason why combined financial statements are prepared;

(c) the basis for determining which entities are included in the combined financial statements;

(d) the basis of preparation of the combined financial statements; and

(e) the **related party** disclosures required by Section 33 *Related Party Disclosures*.

Section 10
Accounting Policies, Estimates and Errors

Scope of this section

10.1 This section provides guidance for selecting and applying the **accounting policies** used in preparing **financial statements**. It also covers **changes in accounting estimates** and corrections of **errors** in prior period financial statements.

Selection and application of accounting policies

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

10.3 If this Standard specifically addresses a transaction, other event or condition, an entity shall apply this Standard. However, the entity need not follow a requirement in this Standard if the effect of doing so would not be **material**.

10.4 If this Standard does not specifically address a transaction, other event or condition, an entity's management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) **relevant** to the economic decision-making needs of users, and

(b) **reliable**, in that the financial statements:

(i) represent faithfully the **financial position**, financial **performance** and **cash flows** of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

10.5 In making the judgement described in paragraph 10.4, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in this Standard dealing with similar and related issues, and

(b) the definitions, **recognition** criteria and **measurement** concepts for **assets**, **liabilities**, **income** and **expenses** and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.

10.6 In making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in **full HKFRSs** dealing with similar and related issues.

Consistency of accounting policies

10.7 An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless this Standard specifically requires or permits categorisation of items for which different policies may be appropriate. If this Standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

10.8 An entity shall change an accounting policy only if the change:

(a) is required by changes to this Standard; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

10.9 The following are not changes in accounting policies:

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

(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material; or

(c) a change to the cost model when a reliable measure of **fair value** is no longer available (or vice versa) for an asset that this Standard would otherwise require or permit to be measured at fair value.

10.10 If this Standard allows a choice of accounting treatment (including the measurement basis) for a specified transaction or other event or condition and an entity changes its previous choice, that is a change in accounting policy.

10.10A The initial application of a policy to revalue assets in accordance with Section 17 *Property, Plant and Equipment* is a change in an accounting policy to be dealt with as a revaluation in accordance with Section 17. Consequently a change from the cost model to the revaluation model for a class of **property, plant and equipment** shall be accounted for prospectively, instead of in accordance with paragraphs 10.11–10.12.

Applying changes in accounting policies

10.11 An entity shall account for changes in accounting policy as follows:

(a) an entity shall account for a change in accounting policy resulting from a change in the requirements of this Standard in accordance with the transitional provisions, if any, specified in that amendment;

(b) when an entity has elected to follow HKAS 39 *Financial Instruments: Recognition and Measurement* instead of following Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues* as permitted by paragraph 11.2, and the requirements of HKAS 39 change, the entity shall account for that change in accounting policy in accordance with the transitional provisions, if any, specified in the revised HKAS 39; and

(c) an entity shall account for all other changes in accounting policy **retrospectively** (see paragraph 10.12).

Retrospective application

10.12 When a change in accounting policy is applied retrospectively in accordance with paragraph 10.11, the entity shall apply the new accounting policy to comparative information for prior periods to the earliest date for which it is practicable, as if the new accounting policy had always been applied. When it is **impracticable** to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the **carrying amounts** of assets and liabilities as at the beginning of the earliest period for which **retrospective application** is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of **equity** for that period.

Disclosure of a change in accounting policy

10.13 When an amendment to this Standard has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose the following:

(a) the nature of the change in accounting policy;

(b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;

(c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c).

Financial statements of subsequent periods need not repeat these disclosures.

10.14 When a voluntary change in accounting policy has an effect on the current period or any prior period, an entity shall disclose the following:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately:

(i) for the current period;

(ii) for each prior period presented; and

(iii) in the aggregate for periods before those presented.

(d) an explanation if it is impracticable to determine the amounts to be disclosed in (c).

Financial statements of subsequent periods need not repeat these disclosures.

Changes in accounting estimates

10.15 A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

10.16 An entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.17 applies, **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.

10.17 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Disclosure of a change in estimate

10.18 An entity shall disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expense for the current period. If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.

Corrections of prior period errors

10.19 Prior period errors are omissions from, and misstatements in, an 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.

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

10.21 To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

10.22 When it is impracticable to determine the effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

Disclosure of prior period errors

10.23 An entity shall disclose the following about prior period errors:

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected;

(c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented; and

(d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c).

Financial statements of subsequent periods need not repeat these disclosures.

Section 11
Basic Financial Instruments

Scope of Sections 11 and 12

11.1 Section 11 and Section 12 *Other Financial Instrument Issues* together deal with recognising, derecognising, measuring and disclosing **financial instruments (financial assets** and **financial liabilities)**. Section 11 applies to basic financial instruments and is relevant to all entities. Section 12 applies to other, more complex financial instruments and transactions. If an entity enters into only basic financial instrument transactions then Section 12 is not applicable. However, even entities with only basic financial instruments shall consider the scope of Section 12 to ensure they are exempt.

Accounting policy choice

11.2 An entity shall choose to apply either:

(a) the requirements of both Sections 11 and 12 in full; or

(b) the **recognition** and **measurement** requirements of HKAS 39 *Financial Instruments: Recognition and Measurement*[2] and the disclosure requirements of Sections 11 and 12

to account for all of its financial instruments. An entity's choice of (a) or (b) is an accounting policy choice. Paragraphs 10.8–10.14 contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for, and what information should be disclosed about the change.

Introduction to Section 11

11.3 A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or **equity** instrument of another entity.

11.4 Section 11 requires an amortised cost model for all basic financial instruments except for investments in non-convertible preference shares and non-puttable ordinary or preference shares that are **publicly traded** or whose **fair value** can otherwise be measured reliably without undue cost or effort.

[2] Until HKAS 39 is superseded by HKFRS 9 *Financial Instruments*, an entity shall apply the version of HKAS 39 that is in effect at the entity's reporting date. When HKAS 39 is superseded by HKFRS 9, an entity shall apply the version of HKAS 39 that applied immediately prior to HKFRS 9 superseding HKAS 39.

11.5 Basic financial instruments within the scope of Section 11 are those that satisfy the conditions in paragraph 11.8. Examples of financial instruments that normally satisfy those conditions include:

(a) **cash**;

(b) demand and fixed-term deposits when the entity is the depositor, for example bank accounts;

(c) commercial paper and commercial bills held;

(d) accounts, notes and loans receivable and payable;

(e) bonds and similar debt instruments;

(f) investments in non-convertible preference shares and non-puttable ordinary and preference shares; and

(g) commitments to receive a loan if the commitment cannot be net settled in cash.

11.6 Examples of financial instruments that do not normally satisfy the conditions in paragraph 11.8, and are therefore within the scope of Section 12, include:

(a) asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables;

(b) options, rights, warrants, futures contracts, forward contracts and interest rate swaps that can be settled in cash or by exchanging another financial instrument;

(c) financial instruments that qualify and are designated as **hedging instruments** in accordance with the requirements in Section 12;

(d) commitments to make a loan to another entity; and

(e) commitments to receive a loan if the commitment can be net settled in cash.

Scope of Section 11

11.7 Section 11 applies to all financial instruments meeting the conditions of paragraph 11.8 except for the following:

(a) investments in **subsidiaries, associates** and **joint ventures** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Investments in Joint Ventures*.

(b) financial instruments that meet the definition of an entity's own equity, including the equity component of **compound financial instruments** issued by the entity (see Section 22 *Liabilities and Equity*).

(c) **leases**, to which Section 20 *Leases* or paragraph 12.3(f) apply. However, the **derecognition** requirements in paragraphs 11.33–11.38 apply to the derecognition of lease receivables recognised by a lessor and lease payables recognised by a lessee, and the impairment requirements in paragraphs 11.21–11.26 apply to lease receivables recognised by a lessor.

(d) employers' rights and obligations under **employee benefit** plans, to which Section 28 *Employee Benefits* applies.

(e) financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 *Share-based Payment* applies.

(f) reimbursement **assets** that are accounted for in accordance with Section 21 *Provisions and Contingencies* (see paragraph 21.9).

Basic financial instruments

11.8 An entity shall account for the following financial instruments as basic financial instruments in accordance with Section 11:

(a) cash;

(b) a debt instrument (such as an account, note, or loan receivable or payable) that meets the conditions in paragraph 11.9;

(c) a commitment to receive a loan that:

(i) cannot be settled net in cash; and

(ii) when the commitment is executed, is expected to meet the conditions in paragraph 11.9.

(d) an investment in non-convertible preference shares and non-puttable ordinary shares or preference shares.

11.9 A debt instrument that satisfies all of the conditions in (a)–(d) below shall be accounted for in accordance with Section 11:

(a) returns to the holder (the lender/creditor) assessed in the currency in which the debt instrument is denominated are either:

(i) a fixed amount;

(ii) a fixed rate of return over the life of the instrument;

(iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR); or

(iv) some combination of such fixed and variable rates, provided that both the fixed and variable rates are positive (for example, an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion).

For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.

(b) there is no contractual provision that could, by its terms, result in the holder (the lender/creditor) losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision.

(c) contractual provisions that permit or require the issuer (the borrower) to prepay a debt instrument or permit or require the holder (the lender/creditor) to put it back to the issuer (ie to demand repayment) before maturity are not contingent on future events other than to protect:

(i) the holder against a change in the credit risk of the issuer or the instrument (for example, defaults, credit downgrades or loan covenant violations) or a change in **control** of the issuer; or

(ii) the holder or issuer against changes in relevant taxation or law.

(d) there are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).

11.9A Examples of debt instruments that would normally satisfy the conditions in paragraph 11.9(a)(iv) include:

(a) a bank loan that has a fixed interest rate for an initial period that then reverts to a quoted or observable variable interest rate after that period; and

(b) a bank loan with interest payable at a quoted or observable variable interest rate plus a fixed rate throughout the life of the loan, for example LIBOR plus 200 basis points.

11.9B An example of a debt instrument that would normally satisfy the conditions set out in paragraph 11.9(c) would be a bank loan that permits the borrower to terminate the arrangement early, even though the borrower may be required to pay a penalty to compensate the bank for its costs of the borrower terminating the arrangement early.

11.10 Other examples of financial instruments that would normally satisfy the conditions in paragraph 11.9 are:

(a) trade accounts and notes receivable and payable, and loans from banks or other third parties.

(b) accounts payable in a foreign currency. However, any change in the account payable because of a change in the exchange rate is recognised in **profit or loss** as required by paragraph 30.10.

(c) loans to or from subsidiaries or associates that are due on demand.

(d) a debt instrument that would become immediately receivable if the issuer defaults on an interest or principal payment (such a provision does not violate the conditions in paragraph 11.9).

11.11 Examples of financial instruments that do not satisfy the conditions in paragraph 11.9 (and are therefore within the scope of Section 12) include:

(a) an investment in another entity's equity instruments other than non-convertible preference shares and non-puttable ordinary and preference shares (see paragraph 11.8(d));

(b) an interest rate swap that returns a cash flow that is positive or negative, or a forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow, because such swaps and forwards do not meet the condition in paragraph 11.9(a);

(c) options and forward contracts, because returns to the holder are not fixed and the condition in paragraph 11.9(a) is not met; and

(d) investments in convertible debt, because the return to the holder can vary with the price of the issuer's equity shares instead of just with market interest rates.

Initial recognition of financial assets and liabilities

11.12 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

11.13 When a financial asset or financial liability is recognised initially, an entity shall measure it at the transaction price (including **transaction costs** except in the initial measurement of financial assets and liabilities that are subsequently measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction for either the entity (for a financial liability) or the counterparty (for a financial asset) to the arrangement. An arrangement constitutes a financing transaction if payment is deferred beyond normal business terms, for example, providing interest-free credit to a buyer for the sale of goods, or is financed at a rate of interest that is not a market rate, for example, an interest-free or below market interest rate loan made to an employee. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the **present value** of the future payments discounted at a market rate of interest for a similar debt instrument as determined at initial recognition.

Examples – financial assets

1 For a long-term loan made to another entity, a receivable is recognised at the present value of cash receivable (including interest payments and repayment of principal) from that entity.

2 For goods sold to a customer on short-term credit, a receivable is recognised at the undiscounted amount of cash receivable from that entity, which is normally the invoice price.

3 For an item sold to a customer on two-year interest-free credit, a receivable is recognised at the current cash sale price for that item. If the current cash sale price is not known, it may be estimated as the present value of the cash receivable discounted using the prevailing market rate(s) of interest for a similar receivable.

4 For a cash purchase of another entity's ordinary shares, the investment is recognised at the amount of cash paid to acquire the shares.

Examples – financial liabilities

1 For a loan received from a bank, a payable is recognised initially at the present value of cash payable to the bank (for example, including interest payments and repayment of principal).

2 For goods purchased from a supplier on short-term credit, a payable is recognised at the undiscounted amount owed to the supplier, which is normally the invoice price.

Subsequent measurement

11.14 At the end of each **reporting period**, an entity shall measure financial instruments as follows, without any deduction for transaction costs the entity may incur on sale or other disposal:

(a) debt instruments that meet the conditions in paragraph 11.8(b) shall be measured at **amortised cost** using the **effective interest method**. Paragraphs 11.15–11.20 provide guidance on determining amortised cost using the effective interest method. Debt instruments that are classified as current assets or current **liabilities** shall be measured at the undiscounted amount of the cash or other consideration expected to be paid or received (ie net of impairment—see paragraphs 11.21–11.26) unless the arrangement constitutes, in effect, a financing transaction (see paragraph 11.13).

(b) commitments to receive a loan that meet the conditions in paragraph 11.8(c) shall be measured at cost (which sometimes is nil) less impairment.

(c) investments in non-convertible preference shares and non-puttable ordinary or preference shares shall be measured as follows (paragraphs 11.27–11.32 provide guidance on fair value):

(i) if the shares are publicly traded or their fair value can otherwise be measured reliably without undue cost or effort, the investment shall be measured at fair value with changes in fair value recognised in profit or loss; and

(ii) all other such investments shall be measured at cost less impairment.

Impairment or uncollectibility must be assessed for financial assets in (a), (b) and (c)(ii). Paragraphs 11.21–11.26 provide guidance.

Amortised cost and effective interest method

11.15 The **amortised cost of a financial asset or financial liability** at each **reporting date** is the net of the following amounts:

(a) the amount at which the financial asset or financial liability is measured at initial recognition;

(b) minus any repayments of the principal;

(c) plus or minus the cumulative **amortisation** using the effective interest method of any difference between the amount at initial recognition and the maturity amount;

(d) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Financial assets and financial liabilities that have no stated interest rate, that do not relate to an arrangement that constitutes a financing transaction and that are classified as current assets or current liabilities are initially measured at an undiscounted amount in accordance with paragraph 11.13. Consequently, (c) does not apply to them.

11.16 The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest **income** or interest **expense** over the relevant period. The **effective interest rate** is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the **carrying amount** of the financial asset or financial liability. The effective interest rate is determined on the basis of the carrying amount of the financial asset or liability at initial recognition. Under the effective interest method:

(a) the amortised cost of a financial asset (liability) is the present value of future cash receipts (payments) discounted at the effective interest rate; and

(b) the interest expense (income) in a period equals the carrying amount of the financial liability (asset) at the beginning of a period multiplied by the effective interest rate for the period.

11.17 When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example prepayment, call and similar options) and known credit losses that have been incurred, but it shall not consider possible future credit losses not yet incurred.

11.18 When calculating the effective interest rate, an entity shall amortise any related fees, finance charges paid or received (such as 'points'), transaction costs and other premiums or discounts over the expected life of the instrument, except as follows. The entity shall use a shorter period if that is the period to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date.

11.19 For variable rate financial assets and variable rate financial liabilities, periodic re-estimation of cash flows to reflect changes in market rates of interest alters the effective interest rate. If a variable rate financial asset or variable rate financial liability is recognised initially at an amount equal to the principal receivable or payable at maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.

11.20 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity shall recalculate the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The entity shall recognise the adjustment as income or expense in profit or loss at the date of the revision.

Example of determining amortised cost for a five-year loan using the effective interest method

On 1 January 20X0, an entity acquires a bond for Currency Units (CU)900, incurring transaction costs of CU50. Interest of CU40 is receivable annually, in arrears, over the next five years (31 December 20X0–31 December 20X4).

The bond has a mandatory redemption of CU1,100 on 31 December 20X4.

Year	Carrying amount at beginning of period	Interest income at 6.9583%*	Cash inflow	Carrying amount at end of period
	CU	CU	CU	CU
20X0	950.00	66.10	(40.00)	976.11
20X1	976.11	67.92	(40.00)	1,004.03
20X2	1,004.03	69.86	(40.00)	1,033.89
20X3	1,033.89	71.94	(40.00)	1,065.83
20X4	1,065.83	74.16	(40.00)	1,100.00
			(1,100.00)	0

* The effective interest rate of 6.9583 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount:

$$40/(1.069583)^1 + 40/(1.069583)^2 + 40/(1.069583)^3 + 40/(1.069583)^4 + 1,140/(1.069583)^5 = 950$$

Impairment of financial assets measured at cost or amortised cost

Recognition

11.21 At the end of each reporting period, an entity shall assess whether there is objective evidence of impairment of any financial assets that are measured at cost or amortised cost. If there is objective evidence of impairment, the entity shall recognise an impairment loss in profit or loss immediately.

11.22 Objective evidence that a financial asset or group of assets is impaired includes observable data that come to the attention of the holder of the asset about the following loss events:

(a) significant financial difficulty of the issuer or obligor;

(b) a breach of contract, such as a default or delinquency in interest or principal payments;

(c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider;

(d) it has become **probable** that the debtor will enter bankruptcy or other financial reorganization; or

(e) observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.

11.23 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates.

11.24 An entity shall assess the following financial assets individually for impairment:

(a) all equity instruments regardless of significance; and

(b) other financial assets that are individually significant.

An entity shall assess other financial assets for impairment either individually or grouped on the basis of similar credit risk characteristics.

Measurement

11.25 An entity shall measure an impairment loss on the following financial assets measured at cost or amortised cost as follows:

(a) for a financial asset measured at amortised cost in accordance with paragraph 11.14(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. If such a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

(b) for a financial asset measured at cost less impairment in accordance with paragraph 11.14(b) and (c)(ii) the impairment loss is the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold at the reporting date.

Reversal

11.26 If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the entity shall reverse the previously recognised impairment loss either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset (net of any allowance account) that exceeds what the carrying amount would have been had the impairment not previously been recognised. The entity shall recognise the amount of the reversal in profit or loss immediately.

Fair value

11.27 An entity shall use the following hierarchy to estimate the fair value of an asset:

(a) the best evidence of fair value is a quoted price for an identical asset (or similar asset)in an **active market**. This is usually the current bid price.

(b) when quoted prices are unavailable, the price in a binding sale agreement or a recent transaction for an identical asset (or similar asset) in an arm's length transaction between knowledgeable, willing parties provides evidence of fair value. However this price may not be a good estimate of fair value if there has been a significant change in economic circumstances or a significant period of time between the date of the binding sale agreement, or the transaction, and the measurement date. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (for example, because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), then that price is adjusted.

(c) if the market for the asset is not active and any binding sale agreements or recent transactions of an identical asset (or similar asset) on their own are not a good estimate of fair value, an entity estimates the fair value by using another valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Other sections of this Standard make reference to the fair value guidance in paragraphs 11.27–11.32, including Section 9, Section 12, Section 14, Section 15, Section 16 *Investment Property*, Section 17 *Property, Plant and Equipment* and Section 28.

Valuation technique

11.28 Valuation techniques include using recent arm's length market transactions for an identical asset between knowledgeable, willing parties, if available, reference to the current fair value of another asset that is substantially the same as the asset being measured, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the asset and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

11.29 The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-determined inputs. A valuation technique would be expected to arrive at a reliable estimate of the fair value if

(a) it reasonably reflects how the market could be expected to price the asset; and

(b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk return factors inherent in the asset.

No active market

11.30 The fair value of investments in assets that do not have a quoted market price in an active market is reliably measurable if

(a) the variability in the range of reasonable fair value estimates is not significant for that asset; or

(b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

11.31 There are many situations in which the variability in the range of reasonable fair value estimates of assets that do not have a quoted market price is likely not to be significant. Normally it is possible to estimate the fair value of an asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the asset at fair value.

11.32 If a reliable measure of fair value is no longer available for an asset measured at fair value (or is not available without undue cost or effort when such an exemption is provided (see paragraphs 11.14(c) and 12.8(b)), its carrying amount at the last date the asset was reliably measurable becomes its new cost. The entity shall measure the asset at this cost amount less impairment until a reliable measure of fair value becomes available (or becomes available without undue cost or effort when such an exemption is provided).

Derecognition of a financial asset

11.33 An entity shall derecognise a financial asset only when either:

(a) the contractual rights to the cash flows from the financial asset expire or are settled;

(b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or

(c) the entity, despite having retained some significant risks and rewards of ownership, has transferred control of the asset to another party and the other party has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer—in this case, the entity shall:

(i) derecognise the asset; and

(ii) recognise separately any rights and obligations retained or created in the transfer.

The carrying amount of the transferred asset shall be allocated between the rights or obligations retained and those transferred on the basis of their relative fair values at the transfer date. Newly created rights and obligations shall be measured at their fair values at that date. Any difference between the consideration received and the amounts recognised and derecognised in accordance with this paragraph shall be recognised in profit or loss in the period of the transfer.

11.34 If a transfer does not result in derecognition because the entity has retained significant risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. The asset and liability shall not be offset. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.

11.35 If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:

(a) if the transferee has the right by contract or custom to sell or repledge the collateral, the transferor shall reclassify that asset in its **statement of financial position** (for example, as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets;

(b) if the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral;

(c) if the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral; and

(d) except as provided in (c), the transferor shall continue to carry the collateral as its asset and the transferee shall not recognise the collateral as an asset.

Example – transfer that qualifies for derecognition

An entity sells a group of its accounts receivable to a bank at less than their face amount. The entity continues to handle collections from the debtors on behalf of the bank, including sending monthly statements, and the bank pays the entity a market-rate fee for servicing the receivables. The entity is obliged to remit promptly to the bank any and all amounts collected, but it has no obligation to the bank for slow payment or non-payment by the debtors. In this case, the entity has transferred to the bank substantially all of the risks and rewards of ownership of the receivables. Accordingly, it removes the receivables from its statement of financial position (ie derecognises them), and it shows no liability in respect of the proceeds received from the bank. The entity recognises a loss calculated as the difference between the carrying amount of the receivables at the time of sale and the proceeds received from the bank. The entity recognises a liability to the extent that it has collected funds from the debtors but has not yet remitted them to the bank.

Example – transfer that does not qualify for derecognition

The facts are the same as the preceding example except that the entity has agreed to buy back from the bank any receivables for which the debtor is in arrears as to principal or interest for more than 120 days. In this case, the entity has retained the risk of slow payment or non-payment by the debtors—a significant risk with respect to receivables. Accordingly, the entity does not treat the receivables as having been sold to the bank, and it does not derecognise them. Instead, it treats the proceeds from the bank as a loan secured by the receivables. The entity continues to recognise the receivables as an asset until they are collected or written off as uncollectible.

Derecognition of a financial liability

11.36 An entity shall derecognise a financial liability (or a part of a financial liability) only when it is extinguished—ie when the obligation specified in the contract is discharged, is cancelled or expires.

11.37 If an existing borrower and lender exchange financial instruments with substantially different terms, the entities shall account for the transaction as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, an entity shall account for a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) as an extinguishment of the original financial liability and the recognition of a new financial liability.

11.38 The entity shall recognise in profit or loss any difference between the carrying amount of the financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed.

Disclosures

11.39 The following disclosures make reference to disclosures for financial liabilities measured at fair value through profit or loss. Entities that have only basic financial instruments (and therefore do not apply Section 12) will not have any financial liabilities measured at fair value through profit or loss and hence will not need to provide such disclosures.

Disclosure of accounting policies for financial instruments

11.40 In accordance with paragraph 8.5, an entity shall disclose, in the summary of significant **accounting policies**, the measurement basis (or bases) used for financial instruments and the other accounting policies used for financial instruments that are relevant to an understanding of the **financial statements**.

Statement of financial position – categories of financial assets and financial liabilities

11.41 An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities at the reporting date, in total, either in the statement of financial position or in the notes:

(a) financial assets measured at fair value through profit or loss (paragraph 11.14(c)(i) and paragraphs 12.8 and 12.9);

(b) financial assets that are debt instruments measured at amortised cost (paragraph 11.14(a));

(c) financial assets that are equity instruments measured at cost less impairment (paragraph 11.14(c)(ii) and paragraphs 12.8 and 12.9);

(d) financial liabilities measured at fair value through profit or loss (paragraphs 12.8 and 12.9);

(e) financial liabilities measured at amortised cost (paragraph 11.14(a)); and

(f) loan commitments measured at cost less impairment (paragraph 11.14(b)).

11.42 An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its **financial position** and **performance**. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment schedule, and restrictions that the debt instrument imposes on the entity).

11.43 For all financial assets and financial liabilities measured at fair value, the entity shall disclose the basis for determining fair value, for example, quoted market price in an active market or a valuation technique. When a valuation technique is used, the entity shall disclose the assumptions applied in determining fair value for each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.

11.44 If a reliable measure of fair value is no longer available, or is not available without undue cost or effort when such an exemption is provided, for any financial instruments that would otherwise be required to be measured at fair value through profit or loss in accordance with this Standard, the entity shall disclose that fact, the carrying amount of those financial instruments and, if an undue cost or effort exemption has been used, the reasons why a reliable fair value measurement would involve undue cost or effort.

Derecognition

11.45 If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.33–11.35), the entity shall disclose the following for each class of such financial assets:

(a) the nature of the assets;

(b) the nature of the risks and rewards of ownership to which the entity remains exposed; and

(c) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

11.46 When an entity has pledged financial assets as collateral for liabilities or **contingent liabilities**, it shall disclose the following:

(a) the carrying amount of the financial assets pledged as collateral; and

(b) the terms and conditions relating to its pledge.

Defaults and breaches on loans payable

11.47 For **loans payable** recognised at the reporting date for which there is a breach of terms or a default of principal, interest, sinking fund, or redemption terms that have not been remedied by the reporting date, an entity shall disclose the following:

(a) details of that breach or default;

(b) the carrying amount of the related loans payable at the reporting date; and

(c) whether the breach or default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

Items of income, expense, gains or losses

11.48 An entity shall disclose the following items of income, expense, **gains** or losses:

(a) income, expense, gains or losses, including changes in fair value, recognised on:

(i) financial assets measured at fair value through profit or loss;

(ii) financial liabilities measured at fair value through profit or loss;

(iii) financial assets measured at amortised cost; and

(iv) financial liabilities measured at amortised cost.

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not measured at fair value through profit or loss; and

(c) the amount of any impairment loss for each class of financial asset.

Section 12
Other Financial Instrument Issues

Scope of Sections 11 and 12

12.1 Section 11 *Basic Financial Instruments* and Section 12 together deal with recognising, derecognising, measuring, and disclosing **financial instruments (financial assets** and **financial liabilities)**. Section 11 applies to basic financial instruments and is relevant to all entities. Section 12 applies to other, more complex financial instruments and transactions. If an entity enters into only basic financial instrument transactions then Section 12 is not applicable. However, even entities with only basic financial instruments shall consider the scope of Section 12 to ensure they are exempt.

Accounting policy choice

12.2 An entity shall choose to apply either:

(a) the requirements of both Sections 11 and 12 in full; or

(b) the **recognition** and **measurement** requirements of HKAS 39 *Financial Instruments: Recognition and Measurement* and the disclosure requirements of Sections 11 and 12

to account for all of its financial instruments. An entity's choice of (a) or (b) is an accounting policy choice. Paragraphs 10.8–10.14 contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for, and what information should be disclosed about the change in accounting policy.

Scope of Section 12

12.3 Section 12 applies to all financial instruments except the following:

(a) those covered by Section 11.

(b) investments in **subsidiaries**, **associates** and **joint ventures** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Investments in Joint Ventures*.

(c) employers' rights and obligations under **employee benefit** plans (see Section 28 *Employee Benefits*).

(d) rights under **insurance contracts** unless the insurance contract could result in a loss to either party as a result of contractual terms that are unrelated to:

(i) changes in the insured risk;

(ii) changes in foreign exchange rates; or

(iii) a default by one of the counterparties.

(e) financial instruments that meet the definition of an entity's own equity, including the equity component of **compound financial instruments** issued by the entity (see Section 22 *Liabilities and Equity*).

(f) **leases** within the scope of Section 20 *Leases*. Consequently, Section 12 applies to leases that could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:

(i) changes in the price of the leased **asset**;

(ii) changes in foreign exchange rates;

(iii) changes in lease payments based on variable market interest rates; or

(iv) a default by one of the counterparties.

(g) contracts for contingent consideration in a **business combination** (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.

(h) financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 *Share-based Payment* applies.

(i) reimbursement assets that are accounted for in accordance with Section 21 *Provisions and Contingencies* (see paragraph 21.9).

12.4 Most contracts to buy or sell a non-financial item such as a commodity, **inventory**, or **property, plant and equipment** are excluded from this section because they are not financial instruments. However, this section applies to all contracts that impose risks on the buyer or seller that are not typical of contracts to buy or sell non-financial items. For example, this section applies to contracts that could result in a loss to the buyer or seller as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties.

12.5 In addition to the contracts described in paragraph 12.4, this section applies to contracts to buy or sell non-financial items if the contract can be settled net in **cash** or another financial instrument, or by exchanging financial instruments as if the contracts were financial instruments, with the following exception: contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements are not financial instruments for the purposes of this section.

Initial recognition of financial assets and liabilities

12.6 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

12.7 When a financial asset or financial liability is recognised initially, an entity shall measure it at its **fair value**, which is normally the transaction price.

Subsequent measurement

12.8 At the end of each **reporting period**, an entity shall measure all financial instruments within the scope of Section 12 at fair value and recognise changes in fair value in **profit or loss**, except as follows:

(a) some changes in the fair value of **hedging instruments** in a designated hedging relationship are required to be recognised in **other comprehensive income** by paragraph 12.23; and

(b) **equity** instruments that are not **publicly traded** and whose fair value cannot otherwise be measured reliably without undue cost or effort and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, shall be measured at cost less impairment.

12.9 If a reliable measure of fair value is no longer available without undue cost or effort for an equity instrument, or a contract linked to such an instrument that if exercised will result in the delivery of such instruments, that is not publicly traded but is measured at fair value through profit or loss, its fair value at the last date that the instrument was reliably measurable without undue cost or effort is treated as the cost of the instrument. The entity shall measure the instrument at this cost amount less impairment until it is able to determine a reliable measure of fair value without undue cost or effort.

Fair value

12.10 An entity shall apply the guidance on fair value in paragraphs 11.27–11.32 to fair value measurements in accordance with this section as well as for fair value measurements in accordance with Section 11.

12.11 The fair value of a financial liability that is due on demand is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

12.12 An entity shall not include **transaction costs** in the initial measurement of financial assets and liabilities that will be measured subsequently at fair value through profit or loss. If payment for an asset is deferred or is financed at a rate of interest that is not a market rate, the entity shall initially measure the asset at the **present value** of the future payments discounted at a market rate of interest.

Impairment of financial assets measured at cost or amortised cost

12.13 An entity shall apply the guidance on impairment in paragraphs 11.21–11.26 to financial assets measured at cost less impairment in accordance with this section.

Derecognition of a financial asset or financial liability

12.14 An entity shall apply the **derecognition** requirements in paragraphs 11.33–11.38 to financial assets and financial liabilities to which this section applies.

Hedge accounting

12.15 If specified criteria are met, an entity may designate a hedging relationship between a hedging instrument and a **hedged item** in such a way as to qualify for hedge accounting. Hedge accounting permits the **gain** or loss on the hedging instrument and on the hedged item to be recognised in profit or loss at the same time.

12.16 To qualify for hedge accounting, an entity shall comply with all of the following conditions:

(a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.

(b) the hedged risk is one of the risks specified in paragraph 12.17.

(c) the hedging instrument is as specified in paragraph 12.18.

(d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

12.17 This Standard permits hedge accounting only for the following risks:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a **firm commitment** or a **highly probable forecast transaction**;

(c) price risk of a commodity that an entity holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; and

(d) foreign exchange risk in a net investment in a **foreign operation**.

Foreign exchange risk of a debt instrument measured at amortised cost is not in the list above because hedge accounting would not have any significant effect on the **financial statements**. Basic accounts, notes and loans receivable and payable are normally measured at amortised cost (see paragraph 11.5(d)). This would include payables denominated in a foreign currency. Paragraph 30.10 requires any change in the **carrying amount** of the payable because of a change in the exchange rate to be recognised in profit or loss. Consequently, both the change in fair value of the hedging instrument (the cross-currency swap) and the change in the carrying amount of the payable relating to the change in the exchange rate would be recognised in profit or loss and should offset each other except to the extent of the difference between the spot rate (at which the liability is measured) and the forward rate (at which the swap is measured).

12.18 This Standard permits hedge accounting only if the hedging instrument has all of following terms and conditions:

(a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 12.17 that is designated as the hedged risk;

(b) it involves a party external to the reporting entity (ie external to the **group**, segment or individual entity being reported on);

(c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item;

(d) it has a specified maturity date not later than:

(i) the maturity of the financial instrument being hedged;

(ii) the expected settlement of the commodity purchase or sale commitment; or

(iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

Hedge of fixed interest rate risk of a recognised financial instrument or commodity price risk of a commodity held

12.19 If the conditions in paragraph 12.16 are met and the hedged risk is the exposure to a fixed interest rate risk of a debt instrument measured at amortised cost or the commodity price risk of a commodity that it holds, the entity shall:

(a) recognise the hedging instrument as an asset or liability and the change in the fair value of the hedging instrument in profit or loss; and

(b) recognise the change in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item.

12.20 If the hedged risk is the fixed interest rate risk of a debt instrument measured at amortised cost, the entity shall recognise the periodic net cash settlements on the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.

12.21 The entity shall discontinue the hedge accounting specified in paragraph 12.19 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 12.16; or

(c) the entity revokes the designation.

12.22 If hedge accounting is discontinued and the hedged item is an asset or liability carried at amortised cost that has not been derecognised, any gains or losses recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the **effective interest method** over the remaining life of the hedged item.

Hedge of variable interest rate risk of a recognised financial instrument, foreign exchange risk or commodity price risk in a firm commitment or highly probable forecast transaction or a net investment in a foreign operation

12.23 If the conditions in paragraph 12.16 are met and the hedged risk is

(a) the variable interest rate risk in a debt instrument measured at amortised cost;

(b) the foreign exchange risk in a firm commitment or a highly probable forecast transaction;

(c) the commodity price risk in a firm commitment or highly probable forecast transaction; or

(d) the foreign exchange risk in a net investment in a foreign operation,

the entity shall recognise in other comprehensive income the portion of the change in the fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item. The entity shall recognise in profit or loss in each period any excess (in absolute amount) of the cumulative change in the fair value of the hedging instrument over the cumulative change in the fair value of the expected cash flows of the hedged item since inception of the hedge (sometimes called hedge ineffectiveness). The hedging gain or loss recognised in other comprehensive income shall be reclassified to profit or loss when the hedged item is recognised in profit or loss, subject to the requirements in paragraph 12.25. However, the cumulative amount of any exchange differences that relate to a hedge of a net investment in a foreign operation recognised in other comprehensive income shall not be reclassified to profit or loss on disposal or partial disposal of the foreign operation.

12.24 If the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost, the entity shall subsequently recognise in profit or loss the periodic net cash settlements from the interest rate swap that is the hedging instrument in the period in which the net settlements accrue.

12.25 The entity shall discontinue prospectively the hedge accounting specified in paragraph 12.23 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the criteria for hedge accounting in paragraph 12.16;

(c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable; or

(d) the entity revokes the designation.

If the forecast transaction is no longer expected to take place or if the hedged debt instrument measured at amortised cost is derecognised, any gain or loss on the hedging instrument that was recognised in other comprehensive income shall be reclassified to profit or loss.

Disclosures

12.26 An entity applying this section shall make all of the disclosures required in Section 11 incorporating in those disclosures financial instruments that are within the scope of this section as well as those within the scope of Section 11. In addition, if the entity uses hedge accounting, it shall make the additional disclosures in paragraphs 12.27–12.29.

12.27 An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 12.17:

(a) a description of the hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the **reporting date**; and

(c) the nature of the risks being hedged, including a description of the hedged item.

12.28 If an entity uses hedge accounting for a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 12.19–12.22) it shall disclose the following:

(a) the amount of the change in fair value of the hedging instrument recognised in profit or loss for the period; and.

(b) the amount of the change in fair value of the hedged item recognised in profit or loss for the period.

12.29 If an entity uses hedge accounting for a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation (paragraphs 12.23–12.25), it shall disclose the following:

(a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

(b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

(c) the amount of the change in fair value of the hedging instrument that was recognised in other comprehensive income during the period (paragraph 12.23);

(d) the amount that was reclassified to profit or loss for the period (paragraphs 12.23 and 12.25); and

(e) the amount of any excess of the cumulative change in fair value of the hedging instrument over the cumulative change in the fair value of the expected cash flows that was recognised in profit or loss for the period (paragraph 12.23).

Section 13
Inventories

Scope of this section

13.1 This section sets out the principles for recognising and measuring **inventories**. 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.

13.2 This section applies to all inventories, except:

(a) work in progress arising under **construction contracts**, including directly related service contracts (see Section 23 *Revenue*);

(b) **financial instruments** (see Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues*); and

(c) **biological assets** related to **agricultural activity** and **agricultural produce** at the point of harvest (see Section 34 *Specialised Activities*).

13.3 This section does not apply to the **measurement** of inventories held by:

(a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at **fair value less costs to sell** through **profit or loss**; or

(b) commodity brokers and dealers that measure their inventories at fair value less costs to sell through profit or loss.

Measurement of inventories

13.4 An entity shall measure inventories at the lower of cost and estimated selling price less costs to complete and sell.

Cost of inventories

13.5 An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of purchase

13.6 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities) and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

13.7 An entity may purchase inventories on deferred settlement terms. In some cases, the arrangement effectively contains an unstated financing element, for example, a difference between the purchase price for normal credit terms and the deferred settlement amount. In these cases, the difference is recognised as interest **expense** over the period of the financing and is not added to the cost of the inventories.

Costs of conversion

13.8 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as **depreciation** and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Allocation of production overheads

13.9 An entity shall allocate fixed production overheads to the costs of conversion on the basis of the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

Joint products and by-products

13.10 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of raw materials or conversion of each product are not separately identifiable, an entity shall allocate them between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, the entity shall measure them at selling price less costs to complete and sell and deduct this amount from the cost of the main product. As a result, the **carrying amount** of the main product is not **materially** different from its cost.

Other costs included in inventories

13.11 An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

13.12 Paragraph 12.19(b) provides that, in some circumstances, the change in the **fair value** of the **hedging instrument** in a hedge of fixed interest rate risk or commodity price risk of a commodity held adjusts the carrying amount of the commodity.

Costs excluded from inventories

13.13 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary during the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

Cost of inventories of a service provider

13.14 To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of agricultural produce harvested from biological assets

13.15 Section 34 requires that inventories comprising agricultural produce that an entity has harvested from its biological assets shall be measured on initial **recognition** at their fair value less estimated costs to sell at the point of harvest. This becomes the cost of the inventories at that date for application of this section.

Techniques for measuring cost, such as standard costing, retail method and most recent purchase price

13.16 An entity may use techniques such as the standard cost method, the retail method or most recent purchase price for measuring the cost of inventories if the result approximates cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost formulas

13.17 An entity shall measure the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects by using specific identification of their individual costs.

13.18 An entity shall measure the cost of inventories, other than those dealt with in paragraph 13.17, by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted by this Standard.

Impairment of inventories

13.19 Paragraphs 27.2–27.4 require an entity to assess at the end of each **reporting period** whether any inventories are impaired, ie the carrying amount is not fully recoverable (for example, because of damage, obsolescence or declining selling prices). If an item (or group of items) of inventory is impaired, those paragraphs require the entity to measure the inventory at its selling price less costs to complete and sell and to recognise an **impairment loss**. Those paragraphs also require a reversal of a prior impairment in some circumstances.

Recognition as an expense

13.20 When inventories are sold, the entity shall recognise the carrying amount of those inventories as an expense in the period in which the related **revenue** is recognised.

13.21 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are accounted for subsequently in accordance with the section of this Standard relevant to that type of asset.

Disclosures

13.22 An entity shall disclose the following:

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

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

(c) the amount of inventories recognised as an expense during the period;

(d) impairment losses recognised or reversed in profit or loss in accordance with Section 27 *Impairment of Assets*; and.

(e) the total carrying amount of inventories pledged as security for **liabilities**.

Section 14
Investments in Associates

Scope of this section

14.1 This section applies to accounting for **associates** in **consolidated financial statements** and in the **financial statements** of an investor that is not a **parent** but that has an investment in one or more associates. Paragraph 9.26 establishes the requirements for accounting for associates in **separate financial statements**.

Associates defined

14.2 An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a **subsidiary** nor an interest in a **joint venture**.

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

(a) if an investor holds, directly or indirectly (for example, through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case;

(b) conversely, if the investor holds, directly or indirectly (for example, through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated; and

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

Measurement—accounting policy election

14.4 An investor shall account for all of its investments in associates using one of the following:

(a) the cost model in paragraph 14.5;

(b) the equity method in paragraph 14.8; or

(c) the **fair value** model in paragraph 14.9.

Cost model

14.5 An investor shall measure its investments in associates, other than those for which there is a published price quotation (see paragraph 14.7) at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.

14.6 The investor shall recognise dividends and other distributions received from the investment as **income** without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.

14.7 An investor shall measure its investments in associates for which there is a published price quotation using the fair value model (see paragraph 14.9).

Equity method

14.8 Under the equity method of accounting, an equity investment is initially recognised at the transaction price (including **transaction costs**) and is subsequently adjusted to reflect the investor's share of the **profit or loss** and **other comprehensive income** of the associate.

(a) *distributions and other adjustments to carrying amount*. Distributions received from the associate reduce the **carrying amount** of the investment. Adjustments to the carrying amount may also be required as a consequence of changes in the associate's equity arising from items of other comprehensive income.

(b) *potential voting rights*. Although potential voting rights are considered in deciding whether significant influence exists, an investor shall measure its share of profit or loss and other comprehensive income of the associate and its share of changes in the associate's equity on the basis of present ownership interests. Those measurements shall not reflect the possible exercise or conversion of potential voting rights.

(c) *implicit goodwill and fair value adjustments*. On acquisition of the investment in an associate, an investor shall account for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable **assets** of the associate in accordance with paragraphs 19.22–19.24. An investor shall adjust its share of the associate's profits or losses after acquisition to account for additional **depreciation** or **amortisation** of the associate's depreciable or amortisable assets (including **goodwill**) on the basis of the excess of their fair values over their carrying amounts at the time the investment was acquired.

(d) *impairment*. If there is an indication that an investment in an associate may be impaired, an investor shall test the entire carrying amount of the investment for impairment in accordance with Section 27 as a single asset. Any goodwill included as part of the carrying amount of the investment in the associate is not tested separately for impairment but, instead, as part of the test for impairment of the investment as a whole.

(e) *investor's transactions with associates*. The investor shall eliminate unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions to the extent of the investor's interest in the associate. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.

(f) *date of associate's financial statements*. In applying the equity method, the investor shall use the financial statements of the associate as of the same date as the financial statements of the investor unless it is **impracticable** to do so. If it is impracticable, the investor shall use the most recent available financial statements of the associate, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends.

(g) *associate's accounting policies*. If the associate uses **accounting policies** that differ from those of the investor, the investor shall adjust the associate's financial statements to reflect the investor's accounting policies for the purpose of applying the equity method unless it is impracticable to do so.

(h) *losses in excess of investment*. If an investor's share of losses of an associate equals or exceeds the carrying amount of its investment in the associate, the investor shall discontinue recognising its share of further losses. After the investor's interest is reduced to zero, the investor shall recognise additional losses by a **provision** (see Section 21 *Provisions and Contingencies*) only to the extent that the investor has incurred legal or **constructive obligations** or has made payments on behalf of the associate. If the associate subsequently reports profits, the investor shall resume recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

(i) *discontinuing the equity method*. An investor shall cease using the equity method from the date that significant influence ceases.

(i) if the associate becomes a subsidiary or joint venture, the investor shall remeasure its previously held equity interest to fair value and recognise the resulting **gain** or loss, if any, in profit or loss.

(ii) if an investor loses significant influence over an associate as a result of a full or partial disposal, it shall derecognise that associate and recognise in profit or loss the difference between, on the one hand, the sum of the proceeds received plus the fair value of any retained interest and, on the other hand, the carrying amount of the investment in the associate at the date significant influence is lost. Thereafter, the investor shall account for any retained interest using Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues*, as appropriate.

(iii) if an investor loses significant influence for reasons other than a partial disposal of its investment, the investor shall regard the carrying amount of the investment at that date as a new cost basis and shall account for the investment using Sections 11 and 12, as appropriate.

Fair value model

14.9 When an investment in an associate is recognised initially, an investor shall measure it at the transaction price. Transaction price excludes transaction costs.

14.10 At each **reporting date**, an investor shall measure its investments in associates at fair value, with changes in fair value recognised in profit or loss, using the fair value measurement guidance in paragraphs 11.27–11.32. An investor using the fair value model shall use the cost model for any investment in an associate for which fair value cannot be measured reliably without undue cost or effort.

Financial statement presentation

14.11 An investor shall classify investments in associates as non-current assets.

Disclosures

14.12 An entity shall disclose the following:

(a) its **accounting policy** for investments in associates;

(b) the carrying amount of investments in associates (see paragraph 4.2(j)); and

(c) the fair value of investments in associates accounted for using the equity method for which there are published price quotations.

14.13 For investments in associates accounted for by the cost model, an investor shall disclose the amount of dividends and other distributions recognised as income.

14.14 For investments in associates accounted for by the equity method, an investor shall disclose separately its share of the profit or loss of such associates and its share of any **discontinued operations** of such associates.

14.15 For investments in associates accounted for by the fair value model, an investor shall make the disclosures required by paragraphs 11.41–11.44. If an investor applies the undue cost or effort exemption in paragraph 14.10 for any associates it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in associates accounted for under the cost model.

Section 15
Investments in Joint Ventures

Scope of this section

15.1 This section applies to accounting for **joint ventures** in **consolidated financial statements** and in the **financial statements** of an investor that is not a **parent** but that has a **venturer's** interest in one or more joint ventures. Paragraph 9.26 establishes the requirements for accounting for a venturer's interest in a joint venture in **separate financial statements**.

Joint ventures defined

15.2 **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).

15.3 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled **assets**, or **jointly controlled entities**.

Jointly controlled operations

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

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

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

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

Jointly controlled assets

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

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

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

(b) any liabilities that it has incurred;

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

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

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

Jointly controlled entities

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

Measurement—accounting policy election

15.9 A venturer shall account for all of its interests in jointly controlled entities using one of the following:

(a) the cost model in paragraph 15.10;

(b) the equity method in paragraph 15.13; or

(c) the **fair value** model in paragraph 15.14.

Cost model

15.10 A venturer shall measure its investments in jointly controlled entities, other than those for which there is a published price quotation (see paragraph 15.12) at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.

15.11 The venturer shall recognise distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the jointly controlled entity arising before or after the date of acquisition.

15.12 A venturer shall measure its investments in jointly controlled entities for which there is a published price quotation using the fair value model (see paragraph 15.14).

Equity method

15.13 A venturer shall measure its investments in jointly controlled entities by the equity method using the procedures in paragraph 14.8 (substituting 'joint control' where that paragraph refers to 'significant influence').

Fair value model

15.14 When an investment in a jointly controlled entity is recognised initially, a venturer shall measure it at transaction price. Transaction price excludes **transaction costs**.

15.15 At each **reporting date**, a venturer shall measure its investments in jointly controlled entities at fair value, with changes in fair value recognised in **profit or loss**, using the fair value **measurement** guidance in paragraphs 11.27–11.32. A venturer using the fair value model shall use the cost model for any investment in a jointly controlled entity for which fair value cannot be measured reliably without undue cost or effort.

Transactions between a venturer and a joint venture

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

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

If investor does not have joint control

15.18 An investor in a joint venture that does not have joint control shall account for that investment in accordance with Section 11 *Basic Financial Instruments*, Section 12 *Other Financial Instrument Issues* or, if it has significant influence in the joint venture, Section 14 *Investments in Associates*.

Disclosures

15.19 An entity shall disclose the following:

(a) the **accounting policy** it uses for recognising its interests in jointly controlled entities;

(b) the **carrying amount** of investments in jointly controlled entities (see paragraph 4.2(k));

(c) the fair value of investments in jointly controlled entities accounted for using the equity method for which there are published price quotations; and

(d) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves.

15.20 For jointly controlled entities accounted for in accordance with the equity method, the venturer shall also make the disclosures required by paragraph 14.14 for equity method investments.

15.21 For jointly controlled entities accounted for in accordance with the fair value model, the venturer shall make the disclosures required by paragraphs 11.41–11.44. If a venturer applies the undue cost or effort exemption in paragraph 15.15 for any jointly controlled entity it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in jointly controlled entities accounted for under the cost model.

Section 16
Investment Property

Scope of this section

16.1 This section applies to accounting for investments in land or buildings that meet the definition of **investment property** in paragraph 16.2 and some property interests held by a lessee under an **operating lease** (see paragraph 16.3) that are treated like investment property. Only investment property whose **fair value** can be measured reliably without undue cost or effort on an ongoing basis is accounted for in accordance with this section at fair value through **profit or loss**. All other investment property is accounted for using the cost model in Section 17 *Property, Plant and Equipment* and remains within the scope of Section 17 unless a reliable measure of fair value becomes available and it is expected that fair value will be reliably measurable on an ongoing basis.

Definition and initial recognition of investment property

16.2 Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a **finance lease** to earn rentals or for capital appreciation or both, instead of for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

16.3 A property interest that is held by a lessee under an **operating lease** may be classified and accounted for as investment property using this section if, and only if, the property would otherwise meet the definition of an investment property and the lessee can measure the fair value of the property interest without undue cost or effort on an ongoing basis. This classification alternative is available on a property-by-property basis.

16.4 Mixed use property shall be separated between investment property and **property, plant and equipment**. However, if the fair value of the investment property component cannot be measured reliably without undue cost or effort, the entire property shall be accounted for as property, plant and equipment in accordance with Section 17.

Measurement at initial recognition

16.5 An entity shall measure investment property at its cost at initial **recognition**. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other **transaction costs**. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments. An entity shall determine the cost of a self-constructed investment property in accordance with paragraphs 17.10–17.14.

16.6 The initial cost of a property interest held under a **lease** and classified as an investment property shall be as prescribed for a finance lease by paragraph 20.9, even if the lease would otherwise be classified as an operating lease if it was in the scope of Section 20 *Leases*. In other words, the **asset** is recognised at the lower of the fair value of the property and the present value of the **minimum lease payments**. An equivalent amount is recognised as a **liability** in accordance with paragraph 20.9.

Measurement after recognition

16.7 Investment property whose fair value can be measured reliably without undue cost or effort shall be measured at fair value at each **reporting date** with changes in fair value recognised in profit or loss. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Paragraphs 11.27–11.32 provide guidance on determining fair value. An entity shall account for all other investment property using the cost model in Section 17.

Transfers

16.8 If a reliable measure of fair value is no longer available without undue cost or effort for an item of investment property measured using the fair value model, the entity shall thereafter account for that item in accordance with Section 17 until a reliable measure of fair value becomes available. The **carrying amount** of the investment property on that date becomes its cost under Section 17. Paragraph 16.10(e)(iii) requires disclosure of this change. It is a change of circumstances and not a change in accounting policy.

16.9 Other than as required by paragraph 16.8, an entity shall transfer a property to, or from, investment property only when the property first meets, or ceases to meet, the definition of investment property.

Disclosures

16.10 An entity shall disclose the following for all investment property accounted for at fair value through profit or loss (paragraph 16.7):

(a) the methods and significant assumptions applied in determining the fair value of investment property.

(b) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.

(c) the existence and amounts of restrictions on the realisability of investment property or the remittance of **income** and proceeds of disposal.

(d) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

(e) a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:

(i) additions, disclosing separately those additions resulting from acquisitions through **business combinations**;

(ii) net **gains** or losses from fair value adjustments;

(iii) transfers to and from investment property carried at cost less accumulated **depreciation** and **impairment** (see paragraph 16.8);

(iv) transfers to and from **inventories** and owner-occupied property; and

(v) other changes.

This reconciliation need not be presented for prior periods.

16.11 In accordance with Section 20, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance lease or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

Section 17
Property, Plant and Equipment

Scope of this section

17.1 This section applies to accounting for **property, plant and equipment** and accounting for **investment property** whose **fair value** cannot be measured reliably without undue cost or effort on an ongoing basis. Section 16 *Investment Property* applies to investment property whose fair value can be measured reliably without undue cost or effort.

17.2 Property, plant and equipment are tangible **assets** that:

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

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

17.3 Property, plant and equipment does not include:

(a) **biological assets** related to **agricultural activity** (see Section 34 *Specialised Activities*); or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Recognition

17.4 An entity shall apply the **recognition** criteria in paragraph 2.27 in determining whether to recognise an item of property, plant or equipment. Consequently, the entity shall recognise the cost of an item of property, plant and equipment as an asset if, and only if:

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

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

17.5 Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this section when they meet the definition of property, plant and equipment. Otherwise, such items are classified as **inventory**.

17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (for example, the roof of a building). An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 17.27–17.30 regardless of whether the replaced parts had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, the entity may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed. Paragraph 17.16 provides that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the

initial cost of the asset to its major components and **depreciate** each such component separately over its **useful life**.

17.7 A condition of continuing to operate an item of property, plant and equipment (for example a bus) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

17.8 Land and buildings are separable assets, and an entity shall account for them separately, even when they are acquired together.

Measurement at recognition

17.9 An entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

17.10 The cost of an item of property, plant and equipment comprises all of the following:

(a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17.11 The following costs are not costs of an item of property, plant and equipment, and an entity shall recognise them as an **expense** when they are incurred:

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training);

(d) administration and other general overhead costs; and

(e) **borrowing costs** (see Section 25 *Borrowing Costs*).

17.12 The **income** and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in **profit or loss** if those operations are not necessary to bring the item to its intended location and operating condition.

Measurement of cost

17.13 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments.

Exchanges of assets

17.14 An item of property, plant or equipment may be acquired in exchange for a non-monetary asset, or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of the acquired asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the carrying amount of the asset given up.

Measurement after initial recognition

17.15 An entity shall choose either the cost model in paragraph 17.15A or the revaluation model in paragraph 17.15B as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. An entity shall apply the cost model to investment property whose fair value cannot be measured reliably without undue cost or effort. An entity shall recognise the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

Cost-model

17.15A An entity shall measure an item of property, plant and equipment after initial recognition at cost less any accumulated **depreciation** and any accumulated **impairment losses**.

Revaluation model

17.15B An entity shall measure an item of property, plant and equipment whose fair value can be measured reliably at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ **materially** from that which would be determined using fair value at the end of the **reporting period**. Paragraphs 11.27–11.32 provide guidance on determining fair value. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

17.15C If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in **other comprehensive income** and accumulated in **equity** under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

17.15D If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

Depreciation

17.16 If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.

17.17 The depreciation charge for each period shall be recognised in profit or loss unless another section of this Standard requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 13 *Inventories*).

Depreciable amount and depreciation period

17.18 An entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.

17.19 Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement and changes in market prices may indicate that the **residual value** or useful life of an asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The entity shall account for the change in residual value, depreciation method or useful life as a change in an **accounting estimate** in accordance with paragraphs 10.15–10.18.

17.20 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

17.21 An entity shall consider all the following factors in determining the useful life of an asset:

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

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

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

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

Depreciation method

17.22 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and a method based on usage such as the units of production method.

17.23 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset's future economic benefits, the entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with paragraphs 10.15–10.18.

Impairment

Recognition and measurement of impairment

17.24 At each reporting date, an entity shall apply Section 27 *Impairment of Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. 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.

Compensation for impairment

17.25 An entity shall include in profit or loss compensation from third parties for items of property, plant and equipment that were impaired, lost or given up only when the compensation becomes receivable.

Property, plant and equipment held for sale

17.26 Paragraph 27.9(f) states that a plan to dispose of an asset before the previously expected date is an indicator of impairment that triggers the calculation of the asset's recoverable amount for the purpose of determining whether the asset is impaired.

Derecognition

17.27 An entity shall derecognise an item of property, plant and equipment:

(a) on disposal, or

(b) when no future economic benefits are expected from its use or disposal.

17.28 An entity shall recognise the **gain** or loss on the **derecognition** of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as **revenue**.

17.29 In determining the date of disposal of an item, an entity shall apply the criteria in Section 23 *Revenue* for recognising revenue from the sale of goods. Section 20 applies to disposal by a sale and leaseback.

17.30 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Disclosures

17.31 An entity shall disclose the following for each class of property, plant and equipment determined in accordance with paragraph 4.11(a) and separately for investment property carried at cost less accumulated depreciation and impairment:

(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 reporting period; and

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

(i) additions;

(ii) disposals;

(iii) acquisitions through **business combinations**;

(iv) increases or decreases resulting from revaluations under paragraphs 17.15B–17.15D and from impairment losses recognised or reversed in other comprehensive income in accordance with Section 27;

(v) transfers to and from investment property carried at fair value through profit or loss (see paragraph 16.8);

(vi) impairment losses recognised or reversed in profit or loss in accordance with Section 27;

(vii) depreciation; and

(viii) other changes.

This reconciliation need not be presented for prior periods.

17.32 An entity shall also disclose the following:

(a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for **liabilities**;

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

(c) if an entity has investment property whose fair value cannot be measured reliably without undue cost or effort it shall disclose that fact and the reasons why fair value measurement would involve undue cost or effort for those items of investment property.

17.33 If items of property, plant and equipment are stated at revalued amounts, an entity shall disclose the following:

(a) the effective date of the revaluation;

(b) whether an independent valuer was involved;

(c) the methods and significant assumptions applied in estimating the items' fair values;

(d) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and

(e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Section 18
Intangible Assets other than Goodwill

Scope of this section

18.1 This section applies to accounting for all **intangible assets** other than **goodwill** (see Section 19 *Business Combinations and Goodwill*) and intangible assets held by an entity for sale in the ordinary course of business (see Section 13 *Inventories* and Section 23 *Revenue*).

18.2 An intangible asset is an identifiable non-monetary **asset** without physical substance. Such an asset is identifiable when:

(a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or **liability**; or

(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

18.3 This section does not apply to the following:

(a) **financial assets**; or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Recognition

General principle for recognising intangible assets

18.4 An entity shall apply the **recognition** criteria in paragraph 2.27 in determining whether to recognise an intangible asset. Consequently, the entity shall recognise an intangible asset as an asset if, and only if:

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

(b) the cost or value of the asset can be measured reliably; and

(c) the asset does not result from expenditure incurred internally on an intangible item.

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

18.6 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

18.7 The probability recognition criterion in paragraph 18.4(a) is always considered satisfied for intangible assets that are separately acquired.

Acquisition as part of a business combination

18.8 An intangible asset acquired in a **business combination** shall be recognised unless its **fair value** cannot be measured reliably without undue cost or effort at the acquisition date.

Initial measurement

18.9 An entity shall measure an intangible asset initially at cost.

Separate acquisition

18.10 The cost of a separately acquired intangible asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, and

(b) any directly attributable cost of preparing the asset for its intended use.

Acquisition as part of a business combination

18.11 If an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date.

Acquisition by way of a government grant

18.12 If an intangible asset is acquired by way of a **government grant**, the cost of that intangible asset is its fair value at the date the grant is received or receivable in accordance with Section 24 *Government Grants*.

Exchanges of assets

18.13 An intangible asset may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of such an intangible asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the **carrying amount** of the asset given up.

Internally generated intangible assets

18.14 An entity shall recognise expenditure incurred internally on an intangible item, including all expenditure for both **research** and **development** activities, as an **expense** when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in this Standard.

18.15 As examples of applying the preceding paragraph, an entity shall recognise expenditure on the following items as an expense and shall not recognise such expenditure as intangible assets:

(a) internally generated brands, logos, publishing titles, customer lists and items similar in substance;

(b) start-up activities (ie start-up costs), which include establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) and expenditure for starting new operations or launching new products or processes (ie pre-operating costs);

(c) training activities;

(d) advertising and promotional activities;

(e) relocating or reorganising part or all of an entity; and

(f) internally generated goodwill.

18.16 Paragraph 18.15 does not preclude recognising a prepayment as an asset when payment for goods or services has been made in advance of the delivery of the goods or the rendering of the services.

Past expenses not to be recognised as an asset

18.17 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised at a later date as part of the cost of an asset.

Measurement after recognition

18.18 An entity shall measure intangible assets at cost less any accumulated **amortisation** and any accumulated **impairment losses**. The requirements for amortisation are set out in this section. The requirements for recognition of impairment are set out in Section 27 *Impairment of Assets*.

Useful life

18.19 For the purpose of this Standard, all intangible assets shall be considered to have a finite useful life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

18.20 If the useful life of an intangible asset cannot be established reliably, the life shall be determined based on management's best estimate but shall not exceed ten years.

Amortisation period and amortisation method

18.21 An entity shall allocate the **depreciable amount** of an intangible asset on a systematic basis over its useful life. The amortisation charge for each period shall be recognised as an expense, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

18.22 Amortisation begins when the intangible asset is available for use, ie when it is in the location and condition necessary for it to be usable in the manner intended by management. Amortisation ceases when the asset is derecognised. The entity shall choose an amortisation method that reflects the pattern in which it expects to consume the asset's future economic benefits. If the entity cannot determine that pattern reliably, it shall use the straight-line method.

Residual value

18.23 An entity shall assume that the **residual value** of an intangible asset is 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) 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.

Review of amortisation period and amortisation method

18.24 Factors such as a change in how an intangible asset is used, technological advancement, and changes in market prices may indicate that the residual value or useful life of an intangible asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, amortisation method or useful life. The entity shall account for the change in residual value, amortisation method or useful life as a **change in an accounting estimate** in accordance with paragraphs 10.15–10.18.

Recoverability of the carrying amount—impairment losses

18.25 To determine whether an intangible asset is impaired, an entity shall apply Section 27. 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

18.26 An entity shall derecognise an intangible asset, and shall recognise a **gain** or loss in **profit or loss**:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

Disclosures

18.27 An entity shall disclose the following for each class of intangible assets:

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

(b) the amortisation methods used;

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

(d) the line item(s) in the **statement of comprehensive income** (and in the **income statement**, if presented) in which any amortisation of intangible assets is included; and

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

(i) additions;

(ii) disposals;

(iii) acquisitions through business combinations;

(iv) amortisation;

(v) impairment losses; and

(vi) other changes.

This reconciliation need not be presented for prior periods.

18.28 An entity shall also disclose:

(a) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is **material** to the entity's **financial statements**.

(b) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 18.12):

(i) the fair value initially recognised for these assets, and

(ii) their carrying amounts.

(c) the existence and carrying amounts of intangible assets to which the entity has restricted title or that are pledged as security for liabilities; and

(d) the amount of contractual commitments for the acquisition of intangible assets.

18.29 An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period (ie the amount of expenditure incurred internally on research and development that has not been capitalised as part of the cost of another asset that meets the recognition criteria in this Standard).

Section 19
Business Combinations and Goodwill

Scope of this section

19.1 This section applies to accounting for **business combinations**. It provides guidance on identifying the acquirer, measuring the cost of the business combination and allocating that cost to the **assets** acquired and **liabilities** and **provisions** for **contingent liabilities** assumed. It also addresses accounting for **goodwill** both at the time of a business combination and subsequently.

19.2 This section specifies the accounting for all business combinations except:

(a) combinations of entities or **businesses** under common **control**. Common control means that all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

(b) the formation of a **joint venture**.

(c) acquisition of a group of assets that do not constitute a business.

Business combinations defined

19.3 A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. The acquisition date is the date on which the acquirer obtains control of the acquiree.

19.4 A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the purchase by an entity of the **equity** of another entity, the purchase of all the net assets of another entity, the assumption of the liabilities of another entity, or the purchase of some of the net assets of another entity that together form one or more businesses.

19.5 A business combination may be effected by the issue of equity instruments, the transfer of **cash**, **cash equivalents** or other assets, or a mixture of these. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.

Accounting

19.6 All business combinations shall be accounted for by applying the purchase method.

19.7 Applying the purchase method involves the following steps:

(a) identifying an acquirer;

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

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

Identifying the acquirer

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

19.9 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. Control of one entity by another is described in Section 9 *Consolidated and Separate Financial Statements*.

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

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

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

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

Cost of a business combination

19.11 The acquirer shall measure the cost of a business combination as the aggregate of:

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

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

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

19.12 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the estimated amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is **probable** and can be measured reliably.

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

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

19.14 The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets and liabilities and a provision for those contingent liabilities that satisfy the **recognition** criteria in paragraph 19. 15 at their fair values at that date except as follows:

(a) a **deferred tax asset** or **deferred tax liability** arising from the assets acquired and liabilities assumed in a business combination shall be recognised and measured in accordance with Section 29 *Income Tax*; and

(b) a liability (or asset, if any) related to the acquiree's **employee benefit** arrangements shall be recognised and measured in accordance with Section 28 *Employee Benefits*.

Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities so recognised shall be accounted for in accordance with paragraphs 19.22–19.24 (as goodwill or so-called 'negative goodwill'). Any **non-controlling interest** in the acquiree is measured at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets.

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

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

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

(c) in the case of an intangible asset, its fair value can be measured reliably without undue cost or effort; and

(d) in the case of a contingent liability, its fair value can be measured reliably.

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

19.17 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.

19.18 In accordance with paragraph 19.14, the acquirer recognises separately only the identifiable assets, liabilities and contingent liabilities of the acquiree that existed at the acquisition date and that satisfy the recognition criteria in paragraph 19.15. Consequently:

(a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with Section 21 *Provisions and Contingencies*; and

(b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.

19.19 If the initial accounting for a business combination is incomplete by the end of the **reporting period** in which the combination occurs, the acquirer shall recognise in its **financial statements** provisional amounts for the items for which the accounting is incomplete. Within twelve months after the acquisition date, the acquirer shall retrospectively adjust the provisional amounts recognised as assets and liabilities at the acquisition date (ie account for them as if they were made at the acquisition date) to reflect new information obtained. Beyond twelve months after the acquisition date, adjustments to the initial accounting for a business combination shall be recognised only to correct an error in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Contingent liabilities

19.20 Paragraph 19.15 specifies that the acquirer recognises separately a provision for a contingent liability of the acquiree only if its fair value can be measured reliably. If its fair value cannot be measured reliably:

(a) there is a resulting effect on the amount recognised as goodwill or accounted for in accordance with paragraph 19.24; and

(b) the acquirer shall disclose the information about that contingent liability as required by Section 21.

19.21 After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 19.15 at the higher of:

(a) the amount that would be recognised in accordance with Section 21, and

(b) the amount initially recognised less amounts previously recognised as **revenue** in accordance with Section 23 *Revenue*.

Goodwill

19.22 The acquirer shall, at the acquisition date:

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

(b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 19.14.

19.23 After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less accumulated **amortisation** and accumulated **impairment losses**:

(a) an entity shall follow the principles in paragraphs 18.19–18.24 for amortisation of goodwill. If the **useful life** of goodwill cannot be established reliably, the life shall be determined based on management's best estimate but shall not exceed ten years.

(b) an entity shall follow Section 27 *Impairment of Assets* for recognising and measuring the impairment of goodwill.

Excess over cost of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities

19.24 If the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities recognised in accordance with paragraph 19.14 exceeds the cost of the business combination (sometimes referred to as 'negative goodwill'), the acquirer shall:

(a) reassess the identification and **measurement** of the acquiree's assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination, and

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

Disclosures

For business combination(s) during the reporting period

19.25 For each business combination during the period, the acquirer shall disclose the following:

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

(b) the acquisition date;

(c) the percentage of voting equity instruments acquired;

(d) the cost of the combination and a description of the components of that cost (such as cash, equity instruments and debt instruments);

(e) the amounts recognised at the acquisition date for each class of the acquiree's assets,liabilities and contingent liabilities, including goodwill;

(f) the amount of any excess recognised in profit or loss in accordance with paragraph 19.24, and the line item in the statement of comprehensive income (and in the **income statement**, if presented) in which the excess is recognised; and

(g) a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, or intangible assets or other items not recognised in accordance with paragraph 19.15.

For all business combinations

19.26 An acquirer shall disclose the useful lives used for goodwill and a reconciliation of the **carrying amount** of goodwill at the beginning and end of the reporting period, showing separately:

(a) changes arising from new business combinations;

(b) impairment losses;

(c) disposals of previously acquired businesses; and

(d) other changes.

This reconciliation need not be presented for prior periods.

Section 20
Leases

Scope of this section

20.1 This section covers accounting for all **leases** other than:

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see Section 34 *Specialised Activities*);

(b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 18 *Intangible Assets other than Goodwill*);

(c) **measurement** of property held by lessees that is accounted for as **investment property** and measurement of investment property provided by lessors under **operating leases** (see Section 16 *Investment Property*);

(d) measurement of **biological assets** held by lessees under **finance leases** and biological assets provided by lessors under operating leases (see Section 34);

(e) leases that could lead to a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased **asset**, changes in foreign exchange rates, changes in lease payments based on variable market interest rates, or a default by one of the counterparties (see paragraph 12.3(f));and

(f) operating leases that are onerous.

20.2 This section applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

20.3 Some arrangements, such as some outsourcing arrangements, telecommunication contracts that provide rights to capacity and take-or-pay contracts, do not take the legal form of a lease but convey rights to use assets in return for payments. Such arrangements are in substance leases of assets and they shall be accounted for under this section.

Classification of leases

20.4 A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

20.5 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction instead of the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

(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 for it to be reasonably certain, at the inception of the lease, 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 such a specialised nature that only the lessee can use them without major modifications.

20.6 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

(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 **residual value** of the leased asset 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 that is substantially lower than market rent.

20.7 The examples and indicators in paragraphs 20.5 and 20.6 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset is transferred to the lessee at the end of the lease for a variable payment equal to the asset's then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all risks and rewards incidental to ownership.

20.8 Lease classification is made at the inception of the lease and is not changed during the term of the lease unless the lessee and the lessor agree to change the provisions of the lease (other than simply by renewing the lease), in which case the lease classification shall be re-evaluated.

Financial statements of lessees—finance leases

Initial recognition

20.9 At the commencement of the lease term, a lessee shall recognise its rights of use and obligations under finance leases as assets and **liabilities** in its **statement of financial position** at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease. Any initial direct costs of the lessee (incremental costs that are directly attributable to negotiating and arranging a lease) are added to the amount recognised as an asset.

20.10 The present value of the minimum lease payments shall be calculated using the **interest rate implicit in the lease**. If this cannot be determined, the **lessee's incremental borrowing rate** shall be used.

Subsequent measurement

20.11 A lessee shall apportion minimum lease payments between the finance charge and the reduction of the outstanding liability using the **effective interest method** (see paragraphs 11.15–11.20). The lessee shall allocate the finance charge to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. A lessee shall charge contingent rents as **expenses** in the periods in which they are incurred.

20.12 A lessee shall depreciate an asset leased under a finance lease in accordance with the relevant section of this Standard for that type of asset, for example Section 17 *Property, Plant and Equipment*, Section 18 or Section 19 *Business Combinations and Goodwill*. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its **useful life**. A lessee shall also assess at each **reporting date** whether an asset leased under a finance lease is impaired (see Section 27 *Impairment of Assets*).

Disclosures

20.13 A lessee shall make the following disclosures for finance leases:

(a) for each **class of asset**, the net **carrying amount** at the end of the **reporting period**.

(b) the total of future minimum lease payments at the end of the reporting period, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases and restrictions imposed by lease arrangements.

20.14 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessees for assets leased under finance leases.

Financial statements of lessees—operating leases

Recognition and measurement

20.15 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense over the lease term on a straight-line basis unless either:

(a) another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis, or

(b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases.

If payments to the lessor vary because of factors other than general inflation, then the condition (b) is not met.

Example of applying paragraph 20.15(b):

X operates in a jurisdiction in which the consensus forecast by local banks is that the general price level index, as published by the government, will increase by an average of 10 per cent annually over the next five years. X leases some office space from Y for five years under an operating lease. The lease payments are structured to reflect the expected 10 per cent annual general inflation over the five-year term of the lease as follows

Year 1	CU100,000
Year 2	CU110,000
Year 3	CU121,000
Year 4	CU133,000
Year 5	CU146,000

X recognises annual rent expense equal to the amounts owed to the lessor. If the escalating payments are not clearly structured to compensate the lessor for expected inflationary cost increases based on published indexes or statistics, then X recognises annual rent expense on a straight-line basis: CU122,000 each year (sum of the amounts payable under the lease divided by five years).

Disclosures

20.16 A lessee shall make the following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(b) lease payments recognised as an expense; and

(c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Financial statements of lessors- finance leases

Initial recognition and measurement

20.17 A lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the **net investment in the lease**. The net investment in a lease is the lessor's **gross investment in the lease** discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:

(a) the minimum lease payments receivable by the lessor under a finance lease, and

(b) any unguaranteed residual value accruing to the lessor.

20.18 For finance leases other than those involving manufacturer or dealer lessors, initial direct costs (costs that are incremental and directly attributable to negotiating and arranging a lease) are included in the initial measurement of the finance lease receivable and reduce the amount of **income** recognised over the lease term.

Subsequent measurement

20.19 The **recognition** of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in **profit or loss**.

Manufacturer or dealer lessors

20.20 Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

(a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts, and

(b) finance income over the lease term.

20.21 The sales **revenue** recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity's policy for outright sales.

20.22 If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

Disclosures

20.23 A lessor shall make the following disclosures for finance leases:

(a) a reconciliation between the gross investment in the lease at the end of the reporting period, and the present value of minimum lease payments receivable at the end of the reporting period. In addition, a lessor shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the end of the reporting period, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(b) unearned finance income.

(c) the unguaranteed residual values accruing to the benefit of the lessor.

(d) the accumulated allowance for uncollectible minimum lease payments receivable.

(e) contingent rents recognised as income in the period.

(f) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Financial statements of lessors- operating leases

Recognition and measurement

20.24 A lessor shall present assets subject to operating leases in its **statement of financial position** according to the nature of the asset.

20.25 A lessor shall recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term, unless either

(a) another systematic basis is representative of the time pattern of the lessee's benefit from the leased asset, even if the receipt of payments is not on that basis, or

(b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases.

If payments to the lessor vary according to factors other than inflation, then condition (b) is not met.

20.26 A lessor shall recognise as an expense costs, including **depreciation**, incurred in earning the lease income. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

20.27 A lessor shall add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.

20.28 To determine whether a leased asset has become impaired, a lessor shall apply Section 27.

20.29 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

Disclosures

20.30 A lessor shall disclose the following for operating leases:

(a) the future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(b) total contingent rents recognised as income; and

(c) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses and restrictions imposed by lease arrangements.

20.31 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessors for assets provided under operating leases.

Sale and leaseback transactions

20.32 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease.

Sale and leaseback transaction results in a finance lease

20.33 If a sale and leaseback transaction results in a finance lease, the seller-lessee shall not recognise immediately, as income, any excess of sales proceeds over the carrying amount. Instead, the seller-lessee shall defer such excess and amortise it over the lease term.

Sale and leaseback transaction results in an operating lease

20.34 If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, the seller-lessee shall recognise any profit or loss immediately. If the sale price is below fair value, the seller-lessee shall recognise any profit or loss immediately unless the loss is compensated for by future lease payments at below market price. In that case the seller-lessee shall defer and amortise such loss 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 seller-lessee shall defer the excess over fair value and amortise it over the period for which the asset is expected to be used.

Disclosures

20.35 Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of significant leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

Section 21
Provisions and Contingencies

Scope of this section

21.1 This section applies to all **provisions** (ie **liabilities** of uncertain timing or amount), **contingent liabilities** and **contingent assets** except those provisions covered by other sections of this Standard. These include provisions relating to:

(a) **leases** (Section 20 *Leases*). However, this section deals with **operating leases** that have become onerous.

(b) **construction contracts** (Section 23 *Revenue*). However this section deals with construction contracts that have become onerous.

(c) **employee benefit** obligations (Section 28 *Employee Benefits*).

(d) income tax (Section 29 *Income Tax*).

21.2 The requirements in this section do not apply to executory contracts unless they are **onerous contracts**. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

21.3 The word 'provision' is sometimes used in the context of such items as **depreciation**, impairment of **assets**, and uncollectible receivables. Those are adjustments of the **carrying amounts** of assets, instead of **recognition** of liabilities, and therefore are not covered by this section.

Initial recognition

21.4 An entity shall recognise a provision only when:

(a) the entity has an obligation at the **reporting date** as a result of a past event;

(b) it is **probable** (ie more likely than not) that the entity will be required to transfer economic benefits in settlement; and

(c) the amount of the obligation can be estimated reliably.

21.5 The entity shall recognise the provision as a liability in the **statement of financial position** and shall recognise the amount of the provision as an **expense**, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

21.6 The condition in paragraph 21.4(a) (obligation at the reporting date as a result of a past event) means that the entity has no realistic alternative to settling the obligation. This can happen when the entity has a legal obligation that can be enforced by law or when the entity has a **constructive obligation** because the past event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. Obligations that will arise from the entity's future actions (ie the future conduct of its business) do not satisfy the condition in paragraph 21.4(a), no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a particular type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation or selling the factory, it has no present obligation for that future expenditure and no provision is recognised.

Initial measurement

21.7 An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the **reporting period** or to transfer it to a third party at that time:

(a) when the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

(b) when the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the entity considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount than the most likely outcome.

When the effect of the time value of money is **material**, the amount of a provision shall be the **present value** of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability shall be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

21.8 An entity shall exclude **gains** from the expected disposal of assets from the **measurement** of a provision.

21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (for example, through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. In the **statement of comprehensive income**, the entity may offset any reimbursement from another party against the expense relating to the provision.

Subsequent measurement

21.10 An entity shall charge against a provision only those expenditures for which the provision was originally recognised.

21.11 An entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in **profit or loss** unless the provision was originally recognised as part of the cost of an asset (see paragraph 21.5). When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognised as a finance cost in profit or loss in the period it arises.

Contingent liabilities

21.12 A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4. An entity shall not recognise a contingent liability as a liability, except for provisions for contingent liabilities of an acquiree in a **business combination** (see paragraphs 19.20 and 19.21). Disclosure of a contingent liability is required by paragraph 21.15 unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

Contingent assets

21.13 An entity shall not recognise a contingent asset as an asset. Disclosure of a contingent asset is required by paragraph 21.16 when an inflow of economic benefits is probable. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

Disclosures

Disclosures about provisions

21.14 For each class of provision, an entity shall disclose all of the following:

(a) a reconciliation showing:

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

(ii) additions during the period, including adjustments that result from changes in measuring the discounted amount;

(iii) amounts charged against the provision during the period; and

(iv) unused amounts reversed during the period.

(b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments;

(c) an indication of the uncertainties about the amount or timing of those outflows; and

(d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Comparative information for prior periods is not required.

Disclosures about contingent liabilities

21.15 Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, when practicable:

(a) an estimate of its financial effect, measured in accordance with paragraphs 21.7–21.11;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

If it is **impracticable** to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

21.16 If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the contingent assets at the end of the reporting period and, unless it would involve undue cost or effort, an estimate of their financial effect, measured using the principles set out in paragraphs 21.7–21.11. If such an estimate would involve undue cost or effort, the entity shall disclose that fact and the reasons why estimating the financial effect would involve undue cost or effort.

Prejudicial disclosures

21.17 In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14–21.16 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 shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Appendix to Section 21
Guidance on recognising and measuring provisions

This Appendix accompanies, but is not part of, Section 21. It provides guidance for applying the requirements of Section 21 in recognising and measuring provisions.

All of the entities in the examples in this Appendix have 31 December as their reporting date. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets; this aspect is not dealt with in the examples. References to 'best estimate' are to the present value amount, when the effect of the time value of money is material.

Example 1 Future operating losses

21A.1 An entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event—there is no past event that obliges the entity to pay out resources.

Conclusion—the entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired—see Section 27 *Impairment of Assets*.

Example 2 Onerous contracts

21A.2 An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, an entity may be contractually required under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event—the entity is contractually required to pay out resources for which it will not receive commensurate benefits.

Conclusion—if an entity has a contract that is onerous, the entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

21A.3 A restructuring is a programme that is planned and controlled by management and materially changes either the scope of a business undertaken by an entity or the manner in which that business is conducted.

Present obligation as a result of a past obligating event—a constructive obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditures that will be undertaken; and

(v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Conclusion—an entity recognises a provision for restructuring costs only when it has a legal or constructive obligation at the reporting date to carry out the restructuring.

Example 4 Warranties

21A.4 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. On the basis of experience, it is probable (ie 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—the entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

Illustration of calculations:

In 20X0, goods are sold for CU1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement costing 70 per cent of sale price. Consequently, estimated warranty costs are:

CU1,000,000 × 90% × 0	= CU0
CU1,000,000 × 6% × 30%	= CU18,000
CU1,000,000 × 4% × 70%	= CU28,000
Total	= CU46,000

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2, and 10 per cent in 20X3, in each case at the end of the period. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the entity uses a 'risk-free' discount rate based on government bonds with the same term as the expected cash outflows (6 per cent for one-year bonds and 7 per cent for two-year and three-year bonds). Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		Expected cash payments (CU)	Discount rate	Discount factor	Present value (CU)
1	60% × CU46,000	27,600	6%	0.9434 (at 6% for 1 year)	26,038
2	30% × CU46,000	13,800	7%	0.8734 (at 7% for 2 years)	12,053
3	10% × CU46,000	4,600	7%	0.8163 (at 7% for 3 years)	3,755
Total					41,846

The entity will recognise a warranty obligation of CU41,846 at the end of 20X0 for products sold in 20X0.

Example 5 Refunds policy

21A.5 A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event—the obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement—probable that a proportion of goods will be returned for refund.

Conclusion—the entity recognises a provision for the best estimate of the amount required to settle the refunds.

Example 6 Closure of a division—no implementation before end of reporting period

21A.6 On 12 December 20X0 the board of an entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event—there has been no obligating event, and so there is no obligation.

Conclusion—the entity does not recognise a provision.

Example 7 Closure of a division—communication and implementation before end of reporting period

21A.7 On 12 December 20X0 the board of an entity decided to close a division making a particular product. On 20 December 20X0 a detailed plan for closing the division was agreed by the board, letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event—the obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement—probable.

Conclusion—the entity recognises a provision at 31 December 20X0 for the best estimate of the costs that would be incurred to close the division at the reporting date.

Example 8 Staff retraining as a result of changes in the income tax system

21A.8 The government introduces changes to the income tax system. As a result of those changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with tax regulations. At the end of the reporting period, no retraining of staff has taken place.

Present obligation as a result of a past obligating event—the tax law change does not impose an obligation on an entity to do any retraining. An obligating event for recognising a provision (the retraining itself) has not taken place.

Conclusion—the entity does not recognise a provision.

Example 9 A court case

21A.9 A customer has sued Entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Entity X. Entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 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 to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the entity will be found liable.

(a) At 31 December 20X1

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 31 December 20X2

Present obligation as a result of a past obligating event—on the basis of the evidence available, there is a present obligation. The obligating event is the sale of the product to the customer.

An outflow of resources embodying economic benefits in settlement— probable.

Conclusion—a provision is recognised at the best estimate of the amount to settle the obligation at 31 December 20X2, and the expense is recognised in profit or loss. It is not a correction of an error in 20X1 because, on the basis of the evidence available when the 20X1 financial statements were approved, a provision should not have been recognised at that time.

Section 22
Liabilities and Equity

Scope of this section

22.1 This section establishes principles for classifying **financial instruments** as either **liabilities** or **equity** and addresses accounting for equity instruments issued to individuals or other parties acting in their capacity as investors in equity instruments (ie in their capacity as **owners**). Section 26 *Share-based Payment* addresses accounting for a transaction in which the entity receives goods or services (including employee services) as consideration for its equity instruments (including shares or share options) from employees and other vendors acting in their capacity as vendors of goods and services.

22.2 This section shall be applied when classifying all types of financial instruments except:

(a) those interests in **subsidiaries**, **associates** and **joint ventures** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Interests in Joint Ventures*.

(b) employers' rights and obligations under **employee benefit** plans, to which Section 28 *Employee Benefits* applies.

(c) contracts for contingent consideration in a **business combination** (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.

(d) financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 applies, except that paragraphs 22.3–22.6 shall be applied to **treasury shares** purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans and all other **share-based payment arrangements**.

Classification of a financial instrument as liability or equity

22.3 Equity is the residual interest in the **assets** of an entity after deducting all its liabilities. 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. Equity includes investments by the owners of the entity, plus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners.

22.3A An entity shall classify a financial instrument as a **financial liability** or as equity in accordance with the substance of the contractual arrangement, not merely its legal form, and in accordance with the definitions of a financial liability and an equity instrument. Unless an entity has an unconditional right to avoid delivering cash or another **financial asset** to settle a contractual obligation, the obligation meets the definition of a financial liability, and is classified as such, except for those instruments classified as equity instruments in accordance with paragraph 22.4.

22.4 Some financial instruments that meet the definition of a liability are classified as equity because they represent the residual interest in the net assets of the entity:

(a) a puttable instrument is a financial instrument that gives the holder the right to sell that instrument back to the issuer for cash or another financial asset or is automatically redeemed or repurchased by the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. A puttable instrument that has all of the following features is classified as an equity instrument:

(i) it entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets.

(ii) the instrument is in the class of instruments that is subordinate to all other classes of instruments.

(iii) all financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features.

(iv) apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments.

(v) the total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the **profit or loss**, the change in the recognised net assets or the change in the **fair value** of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

(b) instruments, or components of instruments, that are subordinate to all other classes of instruments are classified as equity if they impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

22.5 The following are examples of instruments that are classified as liabilities instead of equity:

(a) an instrument is classified as a liability if the distribution of net assets on liquidation is subject to a maximum amount (a ceiling). For example, if on liquidation the holders of the instrument receive a pro rata share of the net assets, but this amount is limited to a ceiling and the excess net assets are distributed to a charity organisation or the government, the instrument is not classified as equity.

(b) a puttable instrument is classified as equity if, when the put option is exercised, the holder receives a pro rata share of the net assets of the entity measured in accordance with this Standard. However, if the holder is entitled to an amount measured on some other basis (such as local GAAP), the instrument is classified as a liability.

(c) an instrument is classified as a liability if it obliges the entity to make payments to the holder before liquidation, such as a mandatory dividend.

(d) a puttable instrument that is classified as equity in a subsidiary's **financial statements** is classified as a liability in its parent entity's consolidated financial statements.

(e) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

22.6 Members' shares in co-operative entities and similar instruments are equity if:

(a) the entity has an unconditional right to refuse redemption of the members' shares; or

(b) redemption is unconditionally prohibited by local law, regulation or the entity's governing charter.

Original issue of shares or other equity instruments

22.7 An entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and another party is obliged to provide cash or other resources to the entity in exchange for the instruments:

(a) if the equity instruments are issued before the entity receives the cash or other resources, the entity shall present the amount receivable as an offset to equity in its **statement of financial position**, not as an asset;

(b) if the entity receives the cash or other resources before the equity instruments are issued, and the entity cannot be required to repay the cash or other resources received, the entity shall recognise the corresponding increase in equity to the extent of consideration received; and

(c) to the extent that the equity instruments have been subscribed for but not issued, and the entity has not yet received the cash or other resources, the entity shall not recognise an increase in equity.

22.8 An entity shall measure equity instruments, other than those issued as part of a business combination or those accounted for in accordance with paragraphs 22.15A–22.15B, at the fair value of the cash or other resources received or receivable, net of **transaction costs**. If payment is deferred and the time value of money is **material**, the initial **measurement** shall be on a **present value** basis.

22.9 An entity shall account for the transaction costs of an equity transaction as a deduction from equity. **Income tax** relating to the transaction costs shall be accounted for in accordance with Section 29 *Income Tax*.

22.10 How the increase in equity arising on the issue of shares or other equity instruments is presented in the statement of financial position is determined by applicable laws. For example, the par value (or other nominal value) of shares and the amount paid in excess of par value may be required to be presented separately.

Sale of options, rights and warrants

22.11 An entity shall apply the principles in paragraphs 22.7–22.10 to equity issued by means of sales of options, rights, warrants and similar equity instruments.

Capitalisation or bonus issues of shares and share splits

22.12 A capitalisation or bonus issue (sometimes referred to as a stock dividend) is the issue of new shares to shareholders in proportion to their existing holdings. For example, an entity may give its shareholders one dividend or bonus share for every five shares held. A share split (sometimes referred to as a stock split) is the dividing of an entity's existing shares into multiple shares. For example, in a share split, each shareholder may receive one additional share for each share held. In some cases, the previously outstanding shares are cancelled and replaced by new shares. Capitalisation and bonus issues and share splits do not change total equity. An entity shall reclassify amounts within equity as required by applicable laws.

Convertible debt or similar compound financial instruments

22.13 On issuing convertible debt or similar **compound financial instruments** that contain both a liability and an equity component, an entity shall allocate the proceeds between the liability component and the equity component. To make the allocation, the entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have a conversion feature or similar associated equity component. The entity shall allocate the residual amount as the equity component. Transaction costs shall be allocated between the debt component and the equity component on the basis of their relative fair values.

22.14 The entity shall not revise the allocation in a subsequent period.

22.15 In periods after the instruments were issued, the entity shall account for the liability component as follows:

(a) in accordance with Section 11 *Basic Financial Instruments* if the liability component meets the conditions in paragraph 11.9. In these cases, the entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest **expense** using the **effective interest method** (see paragraphs 11.15–11.20).

(b) in accordance with Section 12 *Other Financial Instrument Issues* if the liability component does not meet the conditions in paragraph 11.9.

Extinguishing financial liabilities with equity instruments

22.15A An entity may renegotiate the terms of a financial liability with a creditor of the entity with the result that the entity extinguishes the liability fully or partially by issuing equity instruments to the creditor. Issuing equity instruments constitutes consideration paid in accordance with paragraph 11.38. An entity shall measure the equity instruments issued at their fair value. However, if the fair value of the equity instruments issued cannot be measured reliably without undue cost or effort, the equity instruments shall be measured at the fair value of the financial liability extinguished. An entity shall derecognise the financial liability, or part of the financial liability, in accordance with paragraphs 11.36–11.38.

22.15B If part of the consideration paid relates to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part that remains outstanding. This allocation should be made on a reasonable basis. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the **recognition** of a new liability as required by paragraph 11.37.

22.15C An entity shall not apply paragraphs 22.15A–22.15B to transactions in situations in which:

(a) the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder;

(b) the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity; or

(c) extinguishing the financial liability by issuing equity instruments is in accordance with the original terms of the financial liability (see paragraphs 22.13–22.15).

Treasury shares

22.16 Treasury shares are the equity instruments of an entity that have been issued and subsequently reacquired by the entity. An entity shall deduct from equity the fair value of the consideration given for the treasury shares. The entity shall not recognise a **gain** or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares.

Distributions to owners

22.17 An entity shall reduce equity for the amount of distributions to its owners (holders of its equity instruments). Income tax relating to distributions to owners shall be accounted for in accordance with Section 29.

22.18 Sometimes an entity distributes assets other than cash to its owners ('non-cash distributions'). When an entity declares such a distribution and has an obligation to distribute non-cash assets to its owners, it shall recognise a liability. It shall measure the liability at the fair value of the assets to be distributed unless it meets the conditions in paragraph 22.18A. At the end of each **reporting period** and at the date of settlement, the entity shall review and adjust the **carrying amount** of the dividend payable to reflect changes in the fair value of the assets to be distributed, with any changes recognised in equity as adjustments to the amount of the distribution. When an entity settles the dividend payable, it shall recognise in profit or loss any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable.

22.18A If the fair value of the assets to be distributed cannot be measured reliably without undue cost or effort, the liability shall be measured at the carrying amount of the assets to be distributed. If prior to settlement the fair value of the assets to be distributed can be measured reliably without undue cost or effort, the liability is remeasured at fair value with a corresponding adjustment made to the amount of the distribution and accounted for in accordance with paragraph 22.18.

22.18B Paragraphs 22.18–22.18A do not apply to the distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution. This exclusion applies to the separate, individual and **consolidated financial statements** of an entity that makes the distribution

Non-controlling interest and transactions in shares of a consolidated subsidiary

22.19 In consolidated financial statements, a **non-controlling interest** in the net assets of a subsidiary is included in equity. An entity shall treat changes in a **parent**'s controlling interest in a subsidiary that do not result in a loss of **control** as transactions with owners in their capacity as owners. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to owners of the parent. An entity shall not recognise gain or loss on these changes. Also, an entity shall not recognise any change in the carrying amounts of assets (including **goodwill**) or liabilities as a result of such transactions.

Disclosures

22.20 If the fair value of the assets to be distributed as described in paragraphs 22.18–22.18A cannot be measured reliably without undue cost or effort, the entity shall disclose that fact and the reasons why a reliable fair value measurement would involve undue cost or effort.

Appendix to Section 22
Example of the issuer's accounting for convertible debt

The Appendix accompanies, but is not part of, Section 22. It provides guidance for applying the requirements of paragraphs 22.13–22.15.

On 1 January 20X5 an entity issues 500 convertible bonds. The bonds are issued at par with a face value of CU100 per bond and are for a five-year term, with no transaction costs. The total proceeds from the issue are CU50,000. Interest is payable annually in arrears at an annual interest rate of 4 per cent. Each bond is convertible, at the holder's discretion, into 25 ordinary shares at any time up to maturity. At the time the bonds are issued, the market interest rate for similar debt that does not have the conversion option is 6 per cent.

When the instrument is issued, the liability component must be valued first, and the difference between the total proceeds on issue (which is the fair value of the instrument in its entirety) and the fair value of the liability component is assigned to the equity component. The fair value of the liability component is calculated by determining its present value using the discount rate of 6 per cent. These calculations and journal entries are illustrated:

	CU
Proceeds from the bond issue (A)	50,000
Present value of principal at the end of five years (see calculations)	37,363
Present value of interest payable annually in arrears for five years	8,425
Present value of liability, which is the fair value of liability component (B)	45,788
Residual, which is the fair value of the equity component (A) – (B)	4,212

The issuer of the bonds makes the following journal entry at issue on 1 January 20X5:

Dr Cash	CU50,000	
Cr Financial Liability – Convertible bond		CU45,788
Cr Equity		CU4,212

The CU4,212 represents a discount on issue of the bonds, so the entry could also be shown 'gross':

Dr Cash	CU50,000	
Dr Bond discount	CU4,212	
Cr Financial Liability – Convertible bond		CU50,000
Cr Equity		CU4,212

After issue, the issuer will amortise the bond discount according to the following table:

	(a) Interest payment (CU)	(b) Total interest expense (CU) = 6% x (e)	(c) Amortisation of bond discount (CU) = (b) – (a)	(d) Bond discount (CU) = (d) – (c)	(e) Net liability (CU) = 50,000 – (d)
1/1/20X5				4,212	45,788
31/12/20X5	2,000	2,747	747	3,465	46,535
31/12/20X6	2,000	2,792	792	2,673	47,327
31/12/20X7	2,000	2,840	840	1,833	48,167
31/12/20X8	2,000	2,890	890	943	49,057
31/12/20X9	2,000	2,943	943	0	50,000
Totals	10,000	14,212	4,212		

At the end of 20X5, the issuer would make the following journal entry:

Dr Interest expense	CU2,747	
Cr Bond discount		CU747
Cr Cash		CU2,000

Calculations

Present value of principal of CU50,000 at 6 per cent

CU50,000/(1.06)^5 = CU37,363

Present value of the interest annuity of CU2,000 (= CU50,000 × 4 per cent) payable at the end of each of five years

The CU2,000 annual interest payments are an annuity—a cash flow stream with a limited number (n) of periodic payments (C), receivable at dates 1 to n. To calculate the present value of this annuity, future payments are discounted by the periodic rate of interest (i) using the following formula:

$$PV = \frac{C}{i} \times [1 - \frac{1}{(1+i)^n}]$$

Therefore, the present value of the CU2,000 interest payments is
(CU2,000/.06) × [1 – [(1/1.06)^5] = CU8,425

This is equivalent to the sum of the present values of the five individual CU2,000 payments, as follows:

	CU
Present value of interest payment at 31 December 20X5 = 2,000/1.06	1,887
Present value of interest payment at 31 December 20X6 = 2,000/1.06^2	1,780
Present value of interest payment at 31 December 20X7 = 2,000/1.06^3	1,679
Present value of interest payment at 31 December 20X8 = 2,000/1.06^4	1,584
Present value of interest payment at 31 December 20X9 = 2,000/1.06^5	1,495
Total	8,425

Yet another way to calculate this is to use a table of present value of an ordinary annuity in arrears, five periods, interest rate of 6 per cent per period. (Such tables are easily found on the Internet.) The present value factor is 4.2124. Multiplying this by the annuity payment of CU2,000 determines the present value of CU8,425.

Section 23
Revenue

Scope of this section

23.1 This section shall be applied in accounting for **revenue** arising from the following transactions and events:

(a) the sale of goods (whether produced by the entity for the purpose of sale or purchased for resale);

(b) the rendering of services;

(c) **construction contracts** in which the entity is the contractor; and

(d) the use by others of entity **assets** yielding interest, royalties or dividends.

23.2 Revenue or other **income** arising from some transactions and events is dealt with in other sections of this Standard:

(a) **lease** agreements (see Section 20 *Leases*);

(b) dividends and other income arising from investments that are accounted for using the equity method (see Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures*);

(c) changes in the **fair value** of **financial assets** and **financial liabilities** or their disposal (see Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues*);

(d) changes in the fair value of **investment property** (see Section 16 *Investment Property*);

(e) initial **recognition** and changes in the fair value of **biological assets** related to **agricultural activity** (see Section 34 *Specialised Activities*); and

(f) initial recognition of **agricultural produce** (see Section 34).

Measurement of revenue

23.3 An entity shall measure revenue at the fair value of the consideration received or receivable. The fair value of the consideration received or receivable takes into account the amount of any trade discounts, prompt settlement discounts and volume rebates allowed by the entity.

23.4 An entity shall include in revenue only the gross inflows of economic benefits received and receivable by the entity on its own account. An entity shall exclude from revenue all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes. In an agency relationship, an entity (the agent) shall include in revenue only the amount of its commission. The amounts collected on behalf of the principal are not revenue of the entity.

Deferred payment

23.5 When the inflow of **cash** or **cash equivalents** is deferred, and the arrangement constitutes in effect a financing transaction, the fair value of the consideration is the **present value** of all future receipts determined using an **imputed rate of interest**. A financing transaction arises when, for example, an entity provides interest-free credit to the buyer or accepts a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. The imputed rate of interest is the more clearly determinable of either:

(a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or

(b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

An entity shall recognise the difference between the present value of all future receipts and the nominal amount of the consideration as interest revenue in accordance with paragraphs 23.28 and 23.29 and Section 11.

Exchanges of goods or services

23.6 An entity shall not recognise revenue:

(a) when goods or services are exchanged for goods or services that are of a similar nature and value, or

(b) when goods or services are exchanged for dissimilar goods or services but the transaction lacks commercial substance.

23.7 An entity shall recognise revenue when goods are sold or services are exchanged for dissimilar goods or services in a transaction that has commercial substance. In that case, the entity shall measure the transaction :

(a) at the fair value of the goods or services received adjusted by the amount of any cash or cash equivalents transferred;

(b) if the amount under (a) cannot be measured reliably, then at the fair value of the goods or services given up adjusted by the amount of any cash or cash equivalents transferred; or

(c) if the fair value of neither the goods or services received nor the goods or services given up can be measured reliably, then at the **carrying amount** of the goods or services given up adjusted by the amount of any cash or cash equivalents transferred.

Identification of the revenue transaction

23.8 An entity usually applies the revenue recognition criteria in this section separately to each transaction. However, an entity applies the recognition criteria to the separately identifiable components of a single transaction when necessary to reflect the substance of the transaction. For example, an entity applies the recognition criteria to the separately identifiable components of a single transaction when the selling price of a product includes an identifiable amount for subsequent servicing. Conversely, an entity applies the recognition criteria to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity applies the recognition criteria to two or more transactions together when it sells goods and, at the same time, enters into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction.

23.9 Sometimes, as part of a sales transaction, an entity grants its customer a loyalty award that the customer may redeem in the future for free or discounted goods or services. In this case, in accordance with paragraph 23.8, the entity shall account for the award credits as a separately identifiable component of the initial sales transaction. The entity shall allocate the fair value of the consideration received or receivable in respect of the initial sale between the award credits and the other components of the sale. The consideration allocated to the award credits shall be measured by reference to their fair value, ie the amount for which the award credits could be sold separately.

Sale of goods

23.10 An entity shall recognise revenue from the sale of goods when all the following conditions are 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.

23.11 The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a time different from the transfer of legal title or the passing of possession.

23.12 An entity does not recognise revenue if it retains significant risks and rewards of ownership. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:

(a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranties;

(b) when the receipt of the revenue from a particular sale is contingent on the buyer selling the goods;

(c) when the goods are shipped subject to installation and the installation is a significant part of the contract that has not yet been completed; and

(d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract, or at the buyer's sole discretion without any reason, and the entity is uncertain about the probability of return.

23.13 If an entity retains only an insignificant risk of ownership, the transaction is a sale and the entity recognises the revenue. For example, a seller recognises revenue when it retains the legal title to the goods solely to protect the collectibility of the amount due. Similarly an entity recognises revenue when it offers a refund if the customer finds the goods faulty or is not satisfied for other reasons and the entity can estimate the returns reliably. In such cases, the entity recognises a **provision** for returns in accordance with Section 21 *Provisions and Contingencies*.

Rendering of services

23.14 When the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the **reporting period** (sometimes referred to as the percentage of completion method). 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 end of the reporting period can be measured reliably; and

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

Paragraphs 23.21–23.27 provide guidance for applying the percentage of completion method.

23.15 When services are performed by an indeterminate number of acts over a specified period of time, an entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.

23.16 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, an entity shall recognise revenue only to the extent of the **expenses** recognised that are recoverable.

Construction contracts

23.17 When the outcome of a construction contract can be estimated reliably, an entity shall recognise contract revenue and contract costs associated with the construction contract as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period (often referred to as the percentage of completion method). Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectibility of billings. Paragraphs 23.21–23.27 provide guidance for applying the percentage of completion method.

23.18 The requirements of this section are usually applied separately to each construction contract. However, in some circumstances, it is necessary to apply this section to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

23.19 When a contract covers a number of assets, the construction of each asset shall be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation, and the contractor and customer are able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

23.20 A group of contracts, whether with a single customer or with several customers, shall be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

Percentage of completion method

23.21 This method is used to recognise revenue from rendering services (see paragraphs 23.14–23.16) and from construction contracts (see paragraphs 23.17–23.20). An entity shall review and, when necessary, revise the estimates of revenue and costs as the service transaction or construction contract progresses.

23.22 An entity shall determine the stage of completion of a transaction or contract using the method that measures most reliably the work performed. Possible methods include:

(a) the proportion that costs incurred for work performed to date bear to the estimated total costs. Costs incurred for work performed to date do not include costs relating to future activity, such as for materials or prepayments.

(b) surveys of work performed.

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

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

23.23 An entity shall recognise costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset if it is probable that the costs will be recovered.

23.24 An entity shall recognise as an expense immediately any costs whose recovery is not probable.

23.25 When the outcome of a contract cannot be estimated reliably:

(a) an entity shall recognise revenue only to the extent of contract costs incurred that it is probable will be recoverable, and

(b) the entity shall recognise contract costs as an expense in the period in which they are incurred.

23.26 When it is probable that total contract costs will exceed total contract revenue on a contract, the expected loss shall be recognised as an expense immediately, with a corresponding provision for an **onerous contract** (see Section 21).

23.27 If the collectibility of an amount already recognised as contract revenue is no longer probable, the entity shall recognise the uncollectible amount as an expense instead of as an adjustment of the amount of contract revenue.

Interest, royalties and dividends

23.28 An entity shall recognise revenue arising from the use by others of entity assets yielding interest, royalties and dividends on the bases set out in paragraph 23.29 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.

23.29 An entity shall recognise revenue on the following bases:

(a) interest shall be recognised using the **effective interest method** as described in paragraphs 11.15–11.20.

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

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

Disclosures

General disclosures about revenue

23.30 An entity shall 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; and

(b) the amount of each category of revenue recognised during the period, showing separately, at a minimum, revenue arising from:

(i) the sale of goods;
(ii) the rendering of services;
(iii) interest;
(iv) royalties;
(v) dividends;
(vi) commissions;
(vii) **government grants**; and
(viii) any other significant types of revenue.

Disclosures relating to revenue from construction contracts

23.31 An entity shall disclose the following:

(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.

23.32 An entity shall 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**.

Appendix to Section 23
Examples of revenue recognition under the principles in Section 23

This Appendix accompanies, but is not part of, Section 23. It provides guidance for applying the requirements of Section 23 in recognising revenue.

23A.1 The following examples focus on particular aspects of a transaction and are not a comprehensive discussion 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; it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

Sale of goods

23A.2 The law in different countries may cause the recognition criteria in Section 23 to 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. Consequently, the examples in this 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.

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

23A.3 The seller recognises revenue 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.

Example 2 Goods shipped subject to conditions: installation and inspection

23A.4 The seller normally recognises revenue when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

(a) the installation process is simple, for example the installation of a factory-tested television receiver that requires only unpacking and connection of power and antennae; or

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

Example 3 Goods shipped subject to conditions: on approval when the buyer has negotiated a limited right of return

23A.5 If there is uncertainty about the possibility of return, the seller recognises revenue when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

Example 4 Goods shipped subject to conditions: consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)

23A.6 The shipper recognises revenue when the goods are sold by the recipient to a third party.

Example 5 Goods shipped subject to conditions: cash on delivery sales

23A.7 The seller recognises revenue when delivery is made and cash is received by the seller or its agent.

Example 6 Layaway sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments

23A.8 The seller recognises revenue from such sales when the goods are delivered. However, when experience indicates that most 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.

Example 7 Orders when payment (or partial payment) is received in advance of delivery for goods not currently held in inventory, for example, the goods are still to be manufactured or will be delivered direct to the buyer from a third party

23A.9 The seller recognises revenue when the goods are delivered to the buyer.

Example 8 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

23A.10 For a sale and repurchase agreement on an asset other than a financial asset, the seller must analyse the terms of the agreement to ascertain whether, in substance, the risks and rewards of ownership have been transferred to the buyer. If they have been transferred, the seller recognises revenue. 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. For a sale and repurchase agreement on a financial asset, the derecognition provisions of Section 11 apply.

Example 9 Sales to intermediate parties, such as distributors, dealers or others for resale

23A.11 The seller generally recognises revenue from such sales when the risks and rewards of ownership have been transferred. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Example 10 Subscriptions to publications and similar items

23A.12 When the items involved are of similar value in each time period, the seller recognises revenue on a straight-line basis over the period in which the items are dispatched. When the items vary in value from period to period, the seller recognises revenue on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Example 11 Instalment sales, under which the consideration is receivable in instalments

23A.13 The seller recognises revenue attributable to the sales price, exclusive of interest, 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 seller recognises the interest element as revenue using the effective interest method.

Example 12 Agreements for the construction of real estate

23A.14 An entity that undertakes the construction of real estate, directly or through subcontractors, and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method, only if:

(a) the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not); or

(b) the buyer acquires and supplies construction materials and the entity provides only construction services.

23A.15 If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver real estate to the buyer, the agreement shall be accounted for as the sale of goods. In this case, the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Instead, the transfer occurs only on delivery of the completed real estate to the buyer.

Example 13 Sale with customer loyalty award

23A.16 An entity sells product A for CU100. Purchasers of product A get an award credit enabling them to buy product B for CU10. The normal selling price of product B is CU18. The entity estimates that 40 per cent of the purchasers of product A will use their award to buy product B at CU10. The normal selling price of product A, after taking into account discounts that are usually offered but that are not available during this promotion, is CU95.

23A.17 The fair value of the award credit is 40%× [CU18 – CU10] = CU3.20. The entity allocates the total revenue of CU100 between product A and the award credit by reference to their relative fair values of CU95 and CU3.20 respectively. Consequently:

(a) Revenue for product A is CU100 × [CU95 ÷ (CU95 + CU3.20)] = CU96.74; and

(b) Revenue for product B is CU100 × [CU3.20 ÷ (CU95 + CU3.20)] = CU3.26

Rendering of services

Example 14 Installation fees

23A.18 The seller recognises installation fees 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.

Example 15 Servicing fees included in the price of the product

23A.19 When the selling price of a product includes an identifiable amount for subsequent servicing (for example after sales support and product enhancement on the sale of software), the seller defers that amount and recognises it 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.

Example 16 Advertising commissions

23A.20 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.

Example 17 Insurance agency commissions

23A.21 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 agent defers the commission, or part of it, and recognises it as revenue over the period during which the policy is in force.

Example 18 Admission fees

23A.22 The seller recognises revenue from artistic performances, banquets and other special events when the event takes place. When a subscription to a number of events is sold, the seller allocates the fee to each event on a basis that reflects the extent to which services are performed at each event.

Example 19 Tuition fees

23A.23 The seller recognises revenue over the period of instruction

Example 20 Initiation, entrance and membership fees

23A.24 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 about its collectibility exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase 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.

Franchise fees

23A.25 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.

Example 21 Franchise fees: Supplies of equipment and other tangible assets

23A.26 The franchisor recognises the fair value of the assets sold as revenue when the items are delivered or title passes.

Example 22 Franchise fees: Supplies of initial and subsequent services

23A.27 The franchisor recognises fees for the provision of continuing services, whether part of the initial fee or a separate fee, 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.

23A.28 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 the 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 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 (such as assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

23A.29 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.

23A.30 If the initial fee is collectible 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.

Example 23 Franchise fees: Continuing franchise fees

23A.31 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.

Example 24 Franchise fees: Agency transactions

23A.32 Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor 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.

Example 25 Fees from the development of customised software

23A.33 The software developer recognises fees from the development of customised software as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

Example 26 Licence fees and royalties

23A.34 The licensor recognises fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) 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 specified technology for a specified period of time.

23A.35 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 and 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 after delivery. Another example is the granting of rights to exhibit a motion picture film in markets in which 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.

23A.36 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.

Section 24
Government Grants

Scope of this section

24.1 This section specifies the accounting for all government grants. A **government grant** is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.

24.3 This section does not cover government assistance that is provided for an entity in the form of benefits that are available in determining **taxable profit** or tax loss, or are determined or limited on the basis of **income tax** liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated **depreciation** allowances and reduced income tax rates. Section 29 *Income Tax* covers accounting for taxes based on **income**.

Recognition and measurement

24.4 An entity shall recognise government grants as follows:

(a) a grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable;

(b) a grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met; and

(c) grants received before the **revenue recognition** criteria are satisfied are recognised as a **liability**.

24.5 An entity shall measure grants at the **fair value** of the **asset** received or receivable.

Disclosures

24.6 An entity shall disclose the following:

(a) the nature and amounts of government grants recognised in the **financial statements**.

(b) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income; and

(c) an indication of other forms of government assistance from which the entity has directly benefited.

24.7 For the purpose of the disclosure required by paragraph 24.6(c), government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. Examples include free technical or marketing advice, the provision of guarantees and loans at nil or low interest rates.

Section 25
Borrowing Costs

Scope of this section

25.1 This section specifies the accounting for **borrowing costs**. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs include:

(a) interest **expense** calculated using the **effective interest method** as described in Section 11 *Basic Financial Instruments*.

(b) finance charges in respect of **finance leases** recognised in accordance with Section 20 *Leases*; and

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

Recognition

25.2 An entity shall recognise all borrowing costs as an expense in **profit or loss** in the period in which they are incurred.

Disclosures

25.3 Paragraph 5.5(b) requires disclosure of finance costs. Paragraph 11.48(b) requires disclosure of total interest expense (using the effective interest method) for **financial liabilities** that are not at **fair value** through profit or loss. This section does not require any additional disclosure.

Section 26
Share-based Payment

Scope of this section

26.1 This section specifies the accounting for all **share-based payment transactions** including those that are equity- or cash-settled or those in which the terms of the arrangement provide a choice of whether the entity settles the transaction in **cash** (or other **assets**) or by issuing **equity** instruments.

26.1A A share-based payment transaction may be settled by another group entity (or a shareholder of any **group** entity) on behalf of the entity receiving the goods or services. This section also applies to an entity that:

(a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction; or

(b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than the payment for goods or services supplied to the entity receiving them.

26.1B In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this section applies (see paragraph 26.17).

26.2 **Cash-settled share-based payment transactions** include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (instead of an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (for example upon cessation of employment) or at the employee's option.

Recognition

26.3 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an **equity-settled share-based payment transaction** or a **liability** if the goods or services were acquired in a cash-settled share-based payment transaction.

26.4 When the goods or services received or acquired in a share-based payment transaction do not qualify for **recognition** as assets, the entity shall recognise them as **expenses**.

Recognition when there are vesting conditions

26.5 If the share-based payments granted to employees vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those share-based payments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the employee as consideration for the share-based payments have been received. In this case, on the **grant date** the entity shall recognise the services received in full, with a corresponding increase in equity or liabilities.

26.6 If the share-based payments do not vest until the employee completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those share-based payments will be received in the future, during the **vesting period**. The entity shall account for those services as they are rendered by the employee during the vesting period, with a corresponding increase in equity or liabilities.

Measurement of equity-settled share-based payment transactions

Measurement principle

26.7 For equity-settled share-based payment transactions, an entity shall measure the goods or services received, and the corresponding increase in equity, at the **fair value** of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received.

26.8 For transactions with employees (including others providing similar services), the fair value of the equity instruments shall be measured at the grant date. For transactions with parties other than employees, the **measurement** date is the date when the entity obtains the goods or the counterparty renders service.

26.9 A grant of equity instruments might be conditional on employees satisfying specified **vesting conditions** related to service or performance. An example of a vesting condition relating to service is when a grant of shares or share options to an employee is conditional on the employee remaining in the entity's employ for a specified period of time. Examples of vesting conditions relating to performance are when a grant of shares or share options is conditional on a specified period of service and on the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a **market vesting condition**). Vesting conditions are accounted for as follows:

(a) all vesting conditions related to employee service or to a non-market performance condition shall be taken into account when estimating the number of equity instruments expected to vest. Subsequently, the entity shall revise that estimate if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. Vesting conditions related to employee service or to a non-market performance condition shall not be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date.

(b) all market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date, with no subsequent adjustment to the estimated fair value, irrespective of the outcome of the market or non-vesting condition, provided that all other vesting conditions are satisfied.

Shares

26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) if an observable market price is available for the equity instruments granted, use that price.

(b) if an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as:

(i) a recent transaction in the entity's shares; or

(ii) a recent independent fair valuation of the entity or its principal assets.

(c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is **impracticable**, indirectly measure the fair value of the shares using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value. Any valuation method used shall be consistent with generally accepted valuation methodologies for valuing equity instruments.

Share options and equity-settled share appreciation rights

26.11 An entity shall measure the fair value of share options and equity-settled share appreciation rights (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) if an observable market price is available for the equity instruments granted, use that price.

(b) if an observable market price is not available, measure the fair value of share options and share appreciation rights granted using entity-specific observable market data such as (a) for a recent transaction in the share options.

(c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an option pricing model. The inputs for the model (such as the weighted average share price, exercise price, expected volatility, option life, expected dividends, and the risk-free interest rate) shall use market data to the greatest extent possible. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity shall derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Modifications to the terms and conditions on which equity instruments were granted

26.12 An entity might modify the terms and conditions on which equity instruments are granted in a manner that is beneficial to the employee, for example, by reducing the exercise price of an option or reducing the vesting period or by modifying or eliminating a performance condition. Alternatively an entity might modify the terms and conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or adding a performance condition. The entity shall take the modified vesting conditions into account in accounting for the share-based payment transaction, as follows:

(a) if the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

(b) if the modification reduces the total fair value of the **share-based payment arrangement**, or apparently is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred.

The requirements in this paragraph are expressed in the context of share-based payment transactions with employees. The requirements also apply to share-based payment transactions with parties other than employees if these transactions are measured by reference to the fair value of the equity instruments granted, but reference to the grant date refers to the date that the entity obtains the goods or the counterparty renders service.

Cancellations and settlements

26.13 An entity shall account for a cancellation or settlement of an equity-settled share-based payment award as an acceleration of vesting, and therefore shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

Cash-settled share-based payment transactions

26.14 For cash-settled share-based payment transactions, an entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each **reporting date** and at the date of settlement, with any changes in fair value recognised in **profit or loss** for the period.

Share-based payment transactions with cash alternatives

26.15 Some share-based payment transactions give either the entity or the counterparty a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments. In such a case, the entity shall account for the transaction as a cash-settled share-based payment transaction unless either

(a) the entity has a past practice of settling by issuing equity instruments, or

(b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument.

In circumstances (a) and (b), the entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraphs 26.7–26.13.

Group plans

26.16 If a share-based payment award is granted by an entity to the employees of one or more group entities, and the group presents **consolidated financial statements** using either the *HKFRS* for *Private Entities* or **full HKFRSs**, the group entities are permitted, as an alternative to the treatment set out in paragraphs 26.3–26.15, to measure the share-based payment expense on the basis of a reasonable allocation of the expense for the group.

Unidentifiable goods or services

26.17 If the identifiable consideration received appears to be less than the fair value of the equity instruments granted or the liability incurred, this situation typically indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received. For example, some jurisdictions have programmes by which **owners** (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). This indicates that other consideration has been or will be received (such as past or future employee services). The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date. For cash-settled transactions, the liability shall be remeasured at the end of each **reporting period** until it is settled in accordance with paragraph 26.14.

Disclosures

26.18 An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period:

(a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (for example, whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.

(b) the number and weighted average exercise prices of share options for each of the following groups of options:

(i) outstanding at the beginning of the period;

(ii) granted during the period;

(iii) forfeited during the period;

(iv) exercised during the period;

(v) expired during the period;

(vi) outstanding at the end of the period; and

(vii) exercisable at the end of the period.

26.19 For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.

26.20 For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.

26.21 For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.

26.22 If the entity is part of a group share-based payment plan, and it measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).

26.23 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its **financial position**:

(a) the total expense recognised in profit or loss for the period; and

(b) the total **carrying amount** at the end of the period for liabilities arising from share-based payment transactions.

Section 27
Impairment of Assets

Objective and scope

27.1 An **impairment loss** occurs when the **carrying amount** of an asset exceeds its **recoverable amount**. This section shall be applied in accounting for the impairment of all assets other than the following, for which other sections of this Standard establish impairment requirements:

(a) **deferred tax assets** (see Section 29 *Income Tax*);

(b) assets arising from **employee benefits** (see Section 28 *Employee Benefits*);

(c) **financial assets** within the scope of Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instrument Issues*;

(d) **investment property** measured at **fair value** (see Section 16 *Investment Property*);

(e) **biological assets** related to agricultural activity measured at fair value less estimated costs to sell (see Section 34 *Specialised Activities*); and

(f) assets arising from construction contracts (see Section 23 *Revenue*).

Impairment of inventories

Selling price less costs to complete and sell

27.2 An entity shall assess at each **reporting date** whether any **inventories** are impaired. The entity shall make the assessment by comparing the carrying amount of each item of inventory (or group of similar items—see paragraph 27.3) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, the entity shall reduce the carrying amount of the inventory (or the group) to its selling price less costs to complete and sell. That reduction is an impairment loss and it is recognised immediately in **profit or loss**.

27.3 If it is **impracticable** to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area for the purpose of assessing impairment.

Reversal of impairment

27.4 An entity shall make a new assessment of selling price less costs to complete and sell at each subsequent reporting date. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss) so that the new carrying amount is the lower of the cost and the revised selling price less costs to complete and sell.

Impairment of assets other than inventories

General principles

27.5 If, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss. Paragraphs 27.11–27.20 provide guidance on measuring recoverable amount.

27.6 An entity shall recognise an impairment loss immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with the revaluation model in Section 17 *Property, Plant and Equipment*. Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with paragraph 17.15D.

Indicators of impairment

27.7 An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.

27.8 If it is not possible to estimate the recoverable amount of the individual asset, an entity shall estimate the recoverable amount of the **cash-generating unit** to which the asset belongs. This may be the case because measuring recoverable amount requires forecasting cash flows, and sometimes individual assets do not generate cash flows by themselves. An asset's cash-generating unit is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

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

External sources of information

(a) during the period, 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.

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect **materially** the discount rate used in calculating an asset's **value in use** and decrease the asset's **fair value less costs to sell**.

(d) the carrying amount of the net assets of the entity is more than the estimated fair value of the entity as a whole (such an estimate may have been made, for example, in relation to the potential sale of part or all of the entity).

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset.

(f) 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 manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs and plans to dispose of an asset before the previously expected date.

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.

27.10 If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining **useful life**, the **depreciation (amortisation)** method or the **residual value** for the asset and adjust it in accordance with the section of this Standard applicable to the asset (for example Section 17 and Section 18 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring recoverable amount

27.11 The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. If it is not possible to estimate the recoverable amount of an individual asset, references in paragraphs 27.12–27.20 to an asset should be read as references also to an asset's cash-generating unit.

27.12 It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. 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.

27.13 If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal.

Fair value less costs to sell

27.14 Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal (paragraphs 11.27–11.32 provide guidance on fair value measurement).

Value in use

27.15 Value in use is the **present value** of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:

(a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

(b) applying the appropriate discount rate to those future cash flows.

27.16 The following elements shall be reflected in the calculation of an asset's value in use:

(a) an estimate of the future cash flows the entity expects to derive from the asset;

(b) expectations about possible variations in the amount or timing of those future cash flows;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the asset; and

(e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

27.17 In measuring value in use, estimates of future cash flows shall include:

(a) projections of cash inflows from the continuing use of the asset;

(b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and

(c) net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life in an arm's length transaction between knowledgeable, willing parties.

The entity may wish to use any recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity may wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

27.18 Estimates of future cash flows shall not include:

(a) cash inflows or outflows from financing activities, or

(b) **income tax** receipts or payments.

27.19 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

(a) a future restructuring to which an entity is not yet committed, or

(b) improving or enhancing the asset's performance.

27.20 The discount rate (rates) used in the present value calculation shall be a pre-tax rate (rates) that reflect(s) current market assessments of:

(a) the time value of money, and

(b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

The discount rate (rates) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

Recognising and measuring an impairment loss for a cash-generating unit

27.21 An impairment loss shall be recognised for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to reduce the carrying amount of any **goodwill** allocated to the cash-generating unit, and

(b) then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the cash-generating unit.

27.22 However, an entity shall not reduce the carrying amount of any asset in the cash-generating unit below the highest of:

(a) its fair value less costs to sell (if determinable);

(b) its value in use (if determinable); and

(c) zero.

27.23 Any excess amount of the impairment loss that cannot be allocated to an asset because of the restriction in paragraph 27.22 shall be allocated to the other assets of the unit pro rata on the basis of the carrying amount of those other assets.

Additional requirements for impairment of goodwill

27.24 Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the fair value of goodwill cannot be measured directly. Consequently, the fair value of goodwill must be derived from measurement of the fair value of the cash-generating unit(s) of which the goodwill is a part.

27.25 For the purpose of impairment testing, goodwill acquired in a **business combination** shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units that is expected to benefit from the synergies of the combination, irrespective of whether other assets or **liabilities** of the acquiree are assigned to those units.

27.26 Part of the recoverable amount of a cash-generating unit is attributable to the **non-controlling interest** in goodwill. For the purpose of impairment testing a non-wholly-owned cash-generating unit with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.

27.27 If goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then for the purposes of testing goodwill the entity shall test the impairment of goodwill by determining the recoverable amount of either:

(a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated (integrated means the acquired business has been restructured or dissolved into the reporting entity or other **subsidiaries**.); or

(b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.

In applying this paragraph, an entity will need to separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities that have not been integrated. Also the entity shall follow the requirements for cash-generating units in this section when calculating the recoverable amount of, and allocating impairment losses and reversals to assets belonging to, the acquired entity or group of entities.

Reversal of an impairment loss

27.28 An impairment loss recognised for goodwill shall not be reversed in a subsequent period.

27.29 For all assets other than goodwill, an entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 27.9. If any such indication exists, the entity shall determine whether all or part of the prior impairment loss should be reversed. The procedure for making that determination will depend on whether the prior impairment loss on the asset was based on:

(a) the recoverable amount of that individual asset (see paragraph 27.30); or

(b) the recoverable amount of the cash-generating unit to which the asset belongs (see paragraph 27.31).

Reversal where recoverable amount was estimated for an individual impaired asset

27.30 When the prior impairment loss was based on the recoverable amount of the individual impaired asset, the following requirements apply:

(a) the entity shall estimate the recoverable amount of the asset at the current reporting date.

(b) if the estimated recoverable amount of the asset exceeds its carrying amount, the entity shall increase the carrying amount to recoverable amount, subject to the limitation described in (c). That increase is a reversal of an impairment loss. The entity shall recognise the reversal immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with the revaluation model in paragraph 17.15B. Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with paragraph 17.15C.

(c) the reversal of an impairment loss shall not increase the carrying amount of the asset above 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.

(d) after a reversal of an impairment loss is recognised, the entity shall adjust the depreciation (amortisation) charge for the asset in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal when recoverable amount was estimated for a cash-generating unit

27.31 When the original impairment loss was based on the recoverable amount of the cash-generating unit to which the asset belongs, the following requirements apply:

(a) the entity shall estimate the recoverable amount of that cash-generating unit at the current reporting date.

(b) if the estimated recoverable amount of the cash-generating unit exceeds its carrying amount, that excess is a reversal of an impairment loss. The entity shall allocate the amount of that reversal to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets, subject to the limitation described in (c). Those increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and be recognised immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with the revaluation model in paragraph 17.15B. Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with paragraph 17.15C.

(c) in allocating a reversal of an impairment loss for a cash-generating unit, the reversal shall not increase the carrying amount of any asset above the lower of

(i) its recoverable amount, and

(ii) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

(d) any excess amount of the reversal of the impairment loss that cannot be allocated to an asset because of the restriction in (c) shall be allocated pro rata to the other assets of the cash-generating unit, except for goodwill.

(e) after a reversal of an impairment loss is recognised, if applicable, the entity shall adjust the depreciation (amortisation) charge for each asset in the cash-generating unit in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Disclosures

27.32 An entity shall disclose the following for each **class of assets** indicated in paragraph 27.33:

(a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) in the **statement of comprehensive income** (and in the **income statement**, if presented) in which those impairment losses are included; and

(b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are reversed.

27.33 An entity shall disclose the information required by paragraph 27.32 for each of the following classes of asset:

(a) inventories;

(b) **property, plant and equipment** (including investment property accounted for by the cost method);

(c) goodwill;

(d) **intangible assets** other than goodwill;

(e) investments in **associates**; and

(f) investments in **joint ventures**.

Section 28
Employee Benefits

Scope of this section

28.1 **Employee benefits** are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to all employee benefits, except for **share-based payment transactions**, which are covered by Section 26 *Share-based Payment*. Employee benefits covered by this section will be one of the following four types:

(a) short-term employee benefits, which are employee benefits (other than **termination benefits**) that are wholly due within twelve months after the end of the period in which the employees render the related service;

(b) **post-employment benefits**, which are employee benefits (other than termination benefits) that are payable after the completion of employment;

(c) other long-term employee benefits, which are employee benefits (other than post-employment benefits and termination benefits) that are not wholly due within twelve months after the end of the period in which the employees render the related service; and

(d) termination benefits, which are employee benefits payable as a result of either:

(i) an entity's decision to terminate an employee's employment before the normal retirement date, or

(ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.

28.2 Employee benefits also include share-based payment transactions by which employees receive **equity** instruments (such as shares or share options) or **cash** or other **assets** of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity. An entity shall apply Section 26 in accounting for share-based payment transactions.

General recognition principle for all employee benefits

28.3 An entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the entity during the **reporting period**:

(a) as a **liability**, after deducting amounts that have been paid either directly to the employees or as a contribution to an employee benefit fund. If the amount paid exceeds the obligation arising from service before the **reporting date**, an entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(b) as an **expense**, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

Short-term employee benefits

Examples

28.4 Short-term employee benefits generally include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) when the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits generally

28.5 When an employee has rendered service to an entity during the reporting period, the entity shall measure the amounts recognised in accordance with paragraph 28.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement—short-term compensated absences

28.6 An entity may compensate employees for absence for various reasons including annual vacation leave and sick leave. Some short-term compensated absences accumulate—they can be carried forward and used in future periods if the employee does not use the current period's entitlement in full. Examples include annual vacation leave and sick leave. An entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The entity shall measure the expected cost of accumulating compensated absences at the undiscounted additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The entity shall present this amount as a current liability at the reporting date.

28.7 An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition—profit-sharing and bonus plans

28.8 An entity shall recognise the expected cost of profit-sharing and bonus payments only when:

(a) the entity has a present legal or constructive obligation to make such payments as a result of past events (this means that the entity has no realistic alternative but to make the payments); and

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

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

28.9 Post-employment benefits include, for example:

(a) retirement benefits, such as pensions; and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are **post-employment benefit plans**. An entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law instead of by action of the entity. In some cases, these arrangements arise from actions of the entity even in the absence of a formal, documented plan.

28.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on their principal terms and conditions.

(a) defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurer, together with investment returns arising from the contributions.

(b) defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the entity's obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more or less than expected) and investment risk (that returns on assets set aside to fund the benefits will differ from expectations) are borne, in substance, by the entity. If actuarial or investment experience is worse than expected, the entity's obligation may be increased, and vice versa if actuarial or investment experience is better than expected.

Multi-employer plans and state plans

28.11 **Multi-employer plans** and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall account for the plan in accordance with paragraph 28.13 as if it was a defined contribution plan and make the disclosures required by paragraph 28.40.

Insured benefits

28.12 An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity has a legal or constructive obligation either:

(a) to pay the employee benefits directly when they become due, or

(b) to pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

A constructive obligation could arise indirectly through the plan, through the mechanism for setting future premiums, or through a **related party** relationship with the insurer. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

Post-employment benefits: defined contribution plans

Recognition and measurement

28.13 An entity shall recognise the contribution payable for a period:

(a) as a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, an entity shall recognise that excess as an asset.

(b) as an expense, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Post-employment benefits: defined benefit plans

Recognition

28.14 In applying the general **recognition** principle in paragraph 28.3 to defined benefit plans, an entity shall recognise:

(a) a liability for its obligations under defined benefit plans net of **plan assets**—its **'defined benefit liability'** (see paragraphs 28.15–28.23); and

(b) the net change in that liability during the period as the cost of its defined benefit plans during the period (see paragraphs 28.24–28.27).

Measurement of the defined benefit liability

28.15 An entity shall measure a defined benefit liability for its obligations under defined benefit plans at the net total of the following amounts:

(a) the **present value** of its obligations under defined benefit plans (its **defined benefit obligation**) at the reporting date (paragraphs 28.16–28.22 provide guidance for measuring this obligation).

(b) minus the **fair value** at the reporting date of plan assets (if any) out of which the obligations are to be settled directly. Paragraphs 11.27–11.32 provide guidance for determining the fair values of those plan assets.

Inclusion of both vested and unvested benefits

28.16 The present value of an entity's obligations under defined benefit plans at the reporting date shall reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet **vested** (see paragraph 28.26) and including the effects of benefit formulas that give employees greater benefits for later years of service. This requires the entity to determine how much benefit is attributable to the current and prior periods on the basis of the plan's benefit formula and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that influence the cost of the benefit. The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible and selected to lead to the best estimate of the future cash flows that will arise under the plan.

Discounting

28.17 An entity shall measure its defined benefit obligation on a discounted present value basis. The entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. In countries with no deep market in such bonds, the entity shall use the market yields (at the reporting date) on government bonds. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

Actuarial valuation method

28.18 If an entity is able, without undue cost or effort, to use the **projected unit credit method** to measure its defined benefit obligation and the related expense, it shall do so. If defined benefits are based on future salaries, the projected unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases. Additionally, the projected unit credit method requires an entity to make various actuarial assumptions in measuring the defined benefit obligation, including discount rates, the expected rates of return on plan assets, expected rates of salary increases, employee turnover, mortality, and (for defined benefit medical plans) medical cost trend rates.

28.19 If an entity is not able, without undue cost or effort, to use the projected unit credit method to measure its obligation and cost under defined benefit plans, the entity is permitted to make the following simplifications in measuring its defined benefit obligation with respect to current employees:

(a) ignore estimated future salary increases (ie assume current salaries continue until current employees are expected to begin receiving post-employment benefits).

(b) ignore future service of current employees (ie assume closure of the plan for existing as well as any new employees).

(c) ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits (ie assume all current employees will receive the post-employment benefits). However, mortality after service (ie life expectancy) will still need to be considered.

An entity that takes advantage of the foregoing **measurement** simplifications must nonetheless include both **vested benefits** and unvested benefits in measuring its defined benefit obligation.

28.20 This Standard does not require an entity to engage an independent actuary to perform the comprehensive actuarial valuation needed to calculate its defined benefit obligation. Nor does it require that a comprehensive actuarial valuation must be done annually. In the periods between comprehensive actuarial valuations, if the principal actuarial assumptions have not changed significantly the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics such as number of employees and salary levels.

Plan introductions, changes, curtailments and settlements

28.21 If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (**income**) in measuring **profit or loss** in the current period. Conversely, if a plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged) in the current period, the defined benefit obligation shall be decreased or eliminated, and the entity shall recognise the resulting **gain** or loss in profit or loss in the current period.

Defined benefit plan asset

28.22 If the present value of the defined benefit obligation at the reporting date is less than the fair value of plan assets at that date, the plan has a surplus. An entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Cost of a defined benefit plan

28.23 An entity shall recognise the net change in its defined benefit liability during the period, other than a change attributable to benefits paid to employees during the period or to contributions from the employer, as the cost of its defined benefit plans during the period. That cost is recognised either entirely in profit or loss as an expense or partly in profit or loss and partly as an item of **other comprehensive income** (see paragraph 28.24) unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Recognition–accounting policy election

28.24 An entity is required to recognise all actuarial gains and losses in the period in which they occur. An entity shall:

(a) recognise all actuarial gains and losses in profit or loss; or

(b) recognise all actuarial gains and losses in other comprehensive income

as an accounting policy election. The entity shall apply its chosen accounting policy consistently to all of its defined benefit plans and all of its actuarial gains and losses. Actuarial gains and losses recognised in other comprehensive income shall be presented in the **statement of comprehensive income**.

28.25 The net change in the defined benefit liability that is recognised as the cost of a defined benefit plan includes:

(a) the change in the defined benefit liability arising from employee service rendered during the reporting period;

(b) interest on the defined benefit obligation during the reporting period;

(c) the returns on any plan assets and the net change in the fair value of recognised reimbursement rights (see paragraph 28.28) during the reporting period;

(d) actuarial gains and losses arising in the reporting period;

(e) increases or decreases in the defined benefit liability resulting from introducing a new plan or changing an existing plan in the reporting period (see paragraph 28.21); and

(f) decreases in the defined benefit liability resulting from curtailing or settling an existing plan in the reporting period (see paragraph 28.21).

28.26 Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not yet vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy vesting requirements. Similarly, although some post-employment benefits (such as post-employment medical benefits) become payable only if a specified event occurs when an employee is no longer employed (such as an illness), an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

28.27 If defined benefits are reduced for amounts that will be paid to employees under government-sponsored plans, an entity shall measure its defined benefit obligations on a basis that reflects the benefits payable under the government plans, but only if:

(a) those plans were enacted before the reporting date; or

(b) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

Reimbursements

28.28 If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In the statement of comprehensive income (or in the **income statement**, if presented), the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

Other long-term employee benefits

28.29 Other long-term employee benefits generally include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

28.30 An entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:

(a) the present value of the benefit obligation at the reporting date; minus

(b) the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

An entity shall recognise the net change in the liability during the period, other than a change attributable to benefits paid to employees during the period or to contributions from the employer, as the cost of its other long-term employee benefits during the period. That cost is recognised entirely in profit or loss as an expense unless another section of this Standard requires it to be recognised as part of the cost of an asset, such as inventories or property, plant and equipment.

Termination benefits

28.31 An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits.

Recognition

28.32 Because termination benefits do not provide an entity with future economic benefits, an entity shall recognise them as an expense in profit or loss immediately.

28.33 When an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits.

28.34 An entity shall recognise termination benefits as a liability and an expense only when the entity is demonstrably committed either:

(a) to terminate the employment of an employee or group of employees before the normal retirement date; or

(b) to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

28.35 An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal from the plan.

Measurement

28.36 An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

28.37 When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their discounted present value.

Group plans

28.38 If a **parent** entity provides benefits to the employees of one or more **subsidiaries** in the **group**, and the parent presents **consolidated financial statements** using either the *HKFRS for Private Entities* or **full HKFRSs**, such subsidiaries are permitted to recognise and measure employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group.

Disclosures

Disclosures about short-term employee benefits

28.39 This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

28.40 An entity shall disclose the amount recognised in profit or loss as an expense for defined contribution plans. If an entity treats a defined benefit multi-employer plan as a defined contribution plan because sufficient information is not available to use defined benefit accounting (see paragraph 28.11) it shall disclose the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan's surplus or deficit and the implications, if any, for the entity.

Disclosures about defined benefit plans

28.41 An entity shall disclose the following information about defined benefit plans (except for any defined multi-employer benefit plans that are accounted for as defined contribution plans in accordance with paragraph 28.11, for which the disclosures in paragraph 28.40 apply instead). If an entity has more than one defined benefit plan, these disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful:

(a) a general description of the type of plan, including **funding** policy;

(b) the entity's accounting policy for recognising actuarial gains and losses (either in profit or loss or as an item of other comprehensive income) and the amount of actuarial gains and losses recognised during the period;

(c) if the entity uses any of the simplifications in paragraph 28.19 in measuring its defined

benefit obligation, it shall disclose that fact and the reasons why using the projected unit credit method to measure its obligation and cost under defined benefit plans would involve undue cost or effort;

(d) the date of the most recent comprehensive actuarial valuation and, if it was not as of the reporting date, a description of the adjustments that were made to measure the defined benefit obligation at the reporting date;

(e) a reconciliation of opening and closing balances of the defined benefit obligation showing separately benefits paid and all other changes;

(f) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, if applicable:

  (i) contributions;

  (ii) benefits paid; and

  (iii) other changes in plan assets.

(g) the total cost relating to defined benefit plans for the period, disclosing separately the amounts:

  (i) recognised in profit or loss as an expense; and

  (ii) included in the cost of an asset.

(h) for each major class of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major class constitutes of the fair value of the total plan assets at the reporting date;

(i) the amounts included in the fair value of plan assets for:

  (i) each class of the entity's own **financial instruments**, and

  (ii) any property occupied by, or other assets used by, the entity.

(j) the actual return on plan assets; and

(k) the principal actuarial assumptions used, including, when applicable:

  (i) the discount rates;

  (ii) the expected rates of return on any plan assets for the periods presented in the **financial statements**;

  (iii) the expected rates of salary increases;

  (iv) medical cost trend rates; and

  (v) any other **material** actuarial assumptions used.

The reconciliations in (e) and (f) need not be presented for prior periods. A subsidiary that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group (see paragraph 28.38) shall, in its separate financial statements, describe its policy for making the allocation and shall make the disclosures in (a)–(k) for the plan as a whole.

Disclosures about other long-term benefits

28.42 For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of funding at the reporting date.

Disclosures about termination benefits

28.43 For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of funding at the reporting date.

28.44 When there is uncertainty about the number of employees who will accept an offer of termination benefits, a **contingent liability** exists. Section 21 *Provisions and Contingencies* requires an entity to disclose information about its contingent liabilities unless the possibility of an outflow in settlement is remote.

Section 29
Income Tax

Scope of this section

29.1 For the purpose of this Standard, **income tax** includes all domestic and foreign taxes that are based on **taxable profit**. Income tax also includes taxes, such as withholding taxes, that are payable by a **subsidiary**, **associate** or **joint venture** on distributions to the reporting entity.

29.2 This section covers accounting for income tax. It requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the **financial statements**. These recognised tax amounts comprise **current tax** and **deferred tax**. Current tax is income tax payable (recoverable) in respect of the taxable profit (tax loss) for the current period or past periods. Deferred tax is income tax payable or recoverable in future periods, generally as a result of the entity recovering or settling its **assets** and **liabilities** for their current **carrying amount**, and the tax effect of the carryforward of currently unused tax losses and tax credits.

29.3 This section does not deal with the methods of accounting for **government grants** (see Section 24 *Government Grants*). However, this section does deal with the accounting for **temporary differences** that may arise from such grants.

Recognition and measurement of current tax

29.4 An entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount paid for the current and past periods exceeds the amount payable for those periods, the entity shall recognise the excess as a current tax asset.

29.5 An entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

29.6 An entity shall measure a current tax liability (asset) at the amount it expects to pay (recover) using the tax rates and laws that have been enacted or **substantively enacted** by the **reporting date**. An entity shall regard tax rates and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so. Paragraphs 29.32–29.33 provide additional **measurement** guidance.

Recognition of deferred tax

General recognition principle

29.7 It is inherent in the **recognition** of an asset or a liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is **probable** that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this section requires an entity to recognise a **deferred tax liability** (**deferred tax asset**) with certain limited exceptions. If the entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability without affecting taxable profit, no deferred tax arises in respect of the asset or liability.

29.8 An entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the differences between the carrying amounts of the entity's assets and liabilities in the **statement of financial position** and the amounts attributed to those assets and liabilities by the tax authorities (such differences are called 'temporary differences'), and the carryforward of currently unused tax losses and tax credits.

Tax bases and temporary differences

29.9 The **tax base** of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

29.10 The tax base of a liability is its carrying amount less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of **revenue** that is received in advance, the tax base of the resulting liability is its carrying amount less any amount of the revenue that will not be taxable in future periods.

29.11 Some items have a tax base but are not recognised as assets and liabilities in the statement of financial position. For example, **research** and **development** costs are recognised as an **expense** when determining **accounting profit** in the period in which they are incurred but may not be permitted as a deduction when determining taxable profit (tax loss) until a later period. The difference between the tax base of the research and development costs, being the amount that the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a **deductible temporary difference** that results in a deferred tax asset.

29.12 Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. In **consolidated financial statements**, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each entity in the group.

29.13 Examples of situations in which temporary differences arise include:

(a) the identifiable assets acquired and liabilities assumed in a **business combination** are recognised at their **fair values** in accordance with Section 19 *Business Combinations and Goodwill*, but no equivalent adjustment is made for tax purposes (for example, the tax base of an asset may remain at cost to the previous owner). The resulting deferred tax asset or liability affects the amount of **goodwill** that an entity recognises.

(b) assets are remeasured but no equivalent adjustment is made for tax purposes. For example, this Standard permits or requires certain assets to be remeasured at fair value or to be revalued (for example, Section 16 *Investment Property* and Section 17 *Property, Plant and Equipment*).

(c) goodwill arises in a business combination, for example, the tax base of goodwill will be nil if taxation authorities do not allow the **amortisation** or the **impairment** of goodwill as a deductible expense when taxable profit is determined and do not permit

the cost of goodwill to be treated as a deductible expense on disposal of the subsidiary.

(d) the tax base of an asset or a liability on initial recognition differs from its initial carrying amount.

(e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures becomes different from the tax base of the investment or interest.

Not all of these temporary differences will give rise to deferred tax assets and liabilities (see paragraphs 29.14 and 29.16).

Taxable temporary differences

29.14 A deferred tax liability shall be recognised for all **taxable temporary differences**, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or a liability in a transaction that:

(i) is not a business combination; and

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability shall be recognised in accordance with paragraph 29.25.

29.15 Some temporary differences arise when **income** or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as **timing differences**. The following are examples of temporary differences of this kind that are taxable temporary differences and that therefore result in deferred tax liabilities:

(a) interest revenue is included in accounting profit on a time-proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable with respect to such revenues is nil, because the revenues do not affect taxable profit until cash is collected.

(b) **depreciation** used when determining taxable profit (tax loss) may differ from that used when determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base, which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities when determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated. If the tax depreciation is less rapid than the accounting depreciation, a deductible temporary difference arises resulting in a deferred tax asset (see paragraph 29.16).

Deductible temporary differences

29.16 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or a liability in a transaction that:

(a) is not a business combination; and

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates and for interests in joint ventures, a deferred tax asset shall be recognised in accordance with paragraph 29.26.

29.17 The following are examples of deductible temporary differences that result in deferred tax assets:

(a) retirement benefit costs may be deducted when determining accounting profit at the time that the service is provided by the employee, but deducted when determining taxable profit either when contributions are paid to a fund by the entity or when retirement benefits are paid by the entity. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset because economic benefits will flow to the entity in the form of a deduction from taxable profits when contributions or retirement benefits are paid.

(b) certain assets may be carried at fair value, without an equivalent adjustment being made for tax purposes. A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

29.18 The reversal of deductible temporary differences results in deductions when taxable profits of future periods are determined. It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity that are expected to reverse:

(a) in the same period as the expected reversal of the deductible temporary difference; or

(b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

29.19 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

(a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). When evaluating whether it will have sufficient taxable profit in future periods, an entity ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from those deductible temporary differences will itself require future taxable profit in order to be utilised,

(b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

29.20 When an entity has a history of recent losses, the entity considers the guidance in paragraphs 29.21–29.22.

Unused tax losses and unused tax credits

29.21 A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. When assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, an entity considers the following criteria:

(a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

29.22 The existence of unused tax losses is strong evidence that future taxable profit may not be available. Consequently, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or to the extent that there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

Reassessment of unrecognised deferred tax assets

29.23 At the end of each **reporting period**, an entity reassesses any unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Investments in subsidiaries, branches and associates and interests in joint ventures

29.24 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates, and interests in joint ventures (for example, in the **parent**'s consolidated financial statements the carrying amount of a subsidiary is the net consolidated assets of that subsidiary, including the carrying amount of any related goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

(a) the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;

(b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and

(c) a reduction in the carrying amount of an investment in an associate to its **recoverable amount**.

Investments may be accounted for differently in the parent's **separate financial statements** compared to the consolidated financial statements, in which case the temporary difference associated with that investment may also differ. For example, in the parent's separate financial statement the carrying amount of a subsidiary will depend on the accounting policy chosen in paragraph 9.26.

29.25 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor or **venturer** is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

29.26 An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures, only to the extent that it is probable that:

(a) the temporary difference will reverse in the foreseeable future; and

(b) taxable profit will be available against which the temporary difference can be utilised.

Measurement of deferred tax

29.27 An entity shall measure a deferred tax liability (asset) using the tax rates and tax laws that have been enacted or substantively enacted by the reporting date. An entity shall regard tax rates and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so.

29.28 When different tax rates apply to different levels of taxable profit, an entity shall measure deferred tax liabilities (assets) using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the deferred tax liability to be settled (deferred tax asset to be realised).

29.29 The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of the related assets and liabilities. Consequently, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement. For example, if the temporary difference arises from an item of income that is expected to be taxable as a capital **gain** in a future period, the deferred **tax expense** is measured using the capital gain tax rate and the tax base that is consistent with recovering the carrying amount through sale.

29.30 If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Section 17, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale. If a deferred tax liability or asset arises from **investment property** that is measured at fair value, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. Accordingly, unless the presumption is rebutted, the measurement of the deferred tax liability or the deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale. This presumption is rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, instead of through sale. If the presumption is rebutted, the requirements of paragraph 29.29 shall be followed.

29.31 The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period. An entity shall reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that recognised deferred tax asset to be utilised. Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Measurement of both current and deferred tax

29.32 An entity shall not discount current or deferred tax assets and liabilities.

29.33 In some jurisdictions, income tax is payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In other jurisdictions, income tax may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In both of those circumstances, an entity shall measure current and deferred tax at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it shall recognise the resulting current or deferred tax liability (asset) and the related tax expense (income).

Withholding tax on dividends

29.34 When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. Such an amount paid or payable to taxation authorities is charged to **equity** as a part of the dividends.

Presentation

Allocation in comprehensive income and equity

29.35 An entity shall recognise tax expense in the same component of **total comprehensive income** (ie continuing operations, **discontinued operations**, or **other comprehensive income**) or equity as the transaction or other event that resulted in the tax expense.

Current/non-current distinction

29.36 When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify any deferred tax assets (liabilities) as current assets (liabilities).

Offsetting

29.37 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities if, and only if, it has a legally enforceable right to set off the amounts and the entity can demonstrate without undue cost or effort that it plans either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Disclosures

29.38 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events.

29.39 An entity shall disclose separately the major components of tax expense (income). Such 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;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce tax expense;

(f) adjustments to deferred tax expense (income) arising from a change in the tax status of the entity or its shareholders;

(g) deferred tax expense (income) arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 29.31; and

(h) the amount of tax expense (income) relating to those changes in **accounting policies** and **errors** that are included in **profit or loss** in accordance with Section 10 *Accounting Policies, Estimates and Errors*, because they cannot be accounted for retrospectively.

29.40 An entity shall disclose the following separately:

(a) the aggregate current and deferred tax relating to items that are recognised as items of other comprehensive income.

(b) the aggregate current and deferred tax relating to items that are charged or credited directly to equity.

(c) an explanation of any significant differences between the tax expense (income) and accounting profit multiplied by the applicable tax rate. For example such differences may arise from transactions such as revenue that are exempt from taxation or expenses that are not deductible in determining taxable profit (tax loss).

(d) an explanation of changes in the applicable tax rate(s) compared with the previous reporting period.

(e) for each type of temporary difference and for each type of unused tax losses and tax credits:

(i) the amount of deferred tax liabilities and deferred tax assets at the end of the reporting period; and

(ii) an analysis of the change in deferred tax liabilities and deferred tax assets during the period.

(f) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the statement of financial position.

(g) in the circumstances described in paragraph 29.33, an explanation of the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.

29.41 If an entity does not offset tax assets and liabilities in accordance with paragraph 29.37 because it is unable to demonstrate without undue cost or effort that it plans to settle them on a net basis or realise them simultaneously, the entity shall disclose the amounts that have not been offset and the reasons why applying the requirement would involve undue cost or effort.

Section 30
Foreign Currency Translation

Scope of this section

30.1 An entity can conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have **foreign operations**. In addition, an entity may present its **financial statements** in a foreign currency. This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a **presentation currency**. Accounting for **financial instruments** that derive their value from the change in a specified foreign exchange rate (for example, foreign currency forward exchange contracts) and hedge accounting of foreign currency items are dealt with in Section 12 *Other Financial Instrument Issues*.

Functional currency

30.2 Each entity shall identify its **functional currency**. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

30.3 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Consequently, the following are the most important factors an entity considers in determining its functional currency:

(a) the currency:

(i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and

(ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

30.4 The following factors may also provide evidence of an entity's functional currency:

(a) the currency in which funds from financing activities (issuing debt and **equity** instruments) are generated; and

(b) the currency in which receipts from operating activities are usually retained.

30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its **subsidiary**, branch, **associate** or **joint venture**):

(a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, instead of being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other **monetary items**, incurs **expenses**, generates **income** and arranges borrowings, all substantially in its local currency.

(b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Reporting foreign currency transactions in the functional currency

Initial recognition

30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) otherwise acquires or disposes of **assets**, or incurs or settles **liabilities**, denominated in a foreign currency.

30.7 An entity shall record a foreign currency transaction, on initial **recognition** in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

30.8 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this Standard. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at the end of the subsequent reporting periods

30.9 At the end of each **reporting period**, an entity shall:

(a) translate foreign currency monetary items using the closing rate;

(b) translate non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction; and

(c) translate non-monetary items that are measured at fair value in a foreign currency using the exchange rates at the date when the fair value was determined.

30.10 An entity shall recognise, in **profit or loss** in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous periods, except as described in paragraph 30.13.

30.11 When another section of this Standard requires a **gain** or loss on a non-monetary item to be recognised in **other comprehensive income**, an entity shall recognise any exchange component of that gain or loss in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, an entity shall recognise any exchange component of that gain or loss in profit or loss.

Net investment in a foreign operation

30.12 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 30.13. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

30.13 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the **separate financial statements** of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (for example **consolidated financial statements** when the foreign operation is a subsidiary), such exchange differences shall be recognised in other comprehensive income and reported as a component of equity. They shall not be recognised in profit or loss on disposal of the net investment.

Change in functional currency

30.14 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

30.15 As noted in paragraphs 30.2–30.5, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

30.16 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.

Use of a presentation currency other than the functional currency

Translation to the presentation currency

30.17 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, the entity shall translate its items of income and expense and **financial position** into the presentation currency. For example, when a **group** contains individual entities with different functional currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

30.18 An entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:

(a) assets and liabilities for each **statement of financial position** presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position.

(b) income and expenses for each **statement of comprehensive income** (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be recognised in other comprehensive income and reported as a component of equity. They shall not subsequently be reclassified to profit or loss.

30.19 For practical reasons, an entity may use a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

30.20 The exchange differences referred to in paragraph 30.18(c) result from:

(a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate; and

(b) translating the opening net assets at a closing rate that differs from the previous closing rate.

When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to the **non-controlling interest** are allocated to, and recognised as part of, non-controlling interest in the consolidated statement of financial position.

30.21 An entity whose functional currency is the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the procedures specified in Section 31 *Hyperinflation*.

Translation of a foreign operation into the investor's presentation currency

30.22 In incorporating the assets, liabilities, income and expenses of a foreign operation with those of the reporting entity, the entity shall follow normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see Section 9 *Consolidated and Separate Financial Statements*) and the translation procedures set out in paragraphs 30.17-30.21. However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements, a reporting entity continues to recognise such an exchange difference in profit or loss or, if it arises from the circumstances described in paragraph 30.13, the entity shall recognise it as other comprehensive income.

30.23 Any **goodwill** arising on the acquisition of a foreign operation and any fair value adjustments to the **carrying amounts** of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 30.18.

Disclosures

30.24 In paragraphs 30.26 and 30.27, references to 'functional currency' apply, in the case of a group, to the functional currency of the **parent**.

30.25 An entity shall disclose the following:

(a) the amount of exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss in accordance with Section 11 *Basic Financial Instruments* and Section 12; and

(b) the amount of exchange differences arising during the period and classified in a separate component of equity at the end of the period.

30.26 An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.

30.27 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

Section 31
Hyperinflation

Scope of this section

31.1 This section applies to an entity whose **functional currency** is the currency of a hyperinflationary economy. It requires such an entity to prepare **financial statements** that have been adjusted for the effects of hyperinflation.

Hyperinflationary economy

31.2 This section does not establish an absolute rate at which an economy is deemed hyperinflationary. An entity shall make that judgement by considering all available information including, but not limited to, the following possible indicators of hyperinflation:

(a) the general population prefers to keep its wealth in non-monetary **assets** or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.

(b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.

(c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.

(d) interest rates, wages and prices are linked to a price index.

(e) the cumulative inflation rate over three years is approaching, or exceeds, 100 per cent.

Measuring unit in the financial statements

31.3 All amounts in the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the end of the **reporting period**. The comparative information for the previous period required by paragraph 3.14, and any information presented in respect of earlier periods, shall also be stated in terms of the measuring unit current at the **reporting date**.

31.4 The restatement of financial statements in accordance with this section requires the use of a general price index that reflects changes in general purchasing power. In most economies there is a recognised general price index, normally produced by the government, that entities will follow.

Procedures for restating historical cost financial statements

Statement of financial position

31.5 **Statement of financial position** amounts not expressed in terms of the measuring unit current at the end of the reporting period are restated by applying a general price index.

31.6 **Monetary items** are not restated because they are expressed in terms of the measuring unit current at the end of the reporting period. Monetary items are money held and items to be received or paid in money.

31.7 Assets and **liabilities** linked by agreement to changes in prices, such as index-linked bonds and loans, are adjusted in accordance with the agreement and presented at this adjusted amount in the restated statement of financial position.

31.8 All other assets and liabilities are non-monetary:

(a) some non-monetary items are carried at amounts current at the end of the reporting period, such as net realisable value and **fair value**, so they are not restated. All other non-monetary assets and liabilities are restated.

(b) most non-monetary items are carried at cost or cost less **depreciation**; hence they are expressed at amounts current at their date of acquisition. The restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the end of the reporting period.

(ba) some non-monetary items are carried at amounts current at dates other than that of acquisition or the reporting date, for example, **property, plant and equipment** that has been revalued at some earlier date. In these cases, the **carrying amounts** are restated from the date of the revaluation.

(c) the restated amount of a non-monetary item is reduced, in accordance with Section 27 *Impairment of Assets*, when it exceeds its **recoverable amount**.

31.9 At the beginning of the first period of application of this section, the components of **equity**, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates the components were contributed or otherwise arose. Any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all the other amounts in the restated statement of financial position.

31.10 At the end of the first period and in subsequent periods, all components of **owners**' equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The changes for the period in owners' equity are disclosed in accordance with Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*.

Statement of comprehensive income and income statement

31.11 All items in the **statement of comprehensive income** (and in the **income statement**, if presented) shall be expressed in terms of the measuring unit current at the end of the reporting period. Consequently, all amounts need to be restated by applying the change in the general price index from the dates when the items of **income** and **expenses** were initially recognised in the financial statements. If general inflation is approximately even throughout the period, and the items of income and expense arose approximately evenly throughout the period, an average rate of inflation may be appropriate.

Statement of cash flows

31.12 An entity shall express all items in the **statement of cash flows** in terms of the measuring unit current at the end of the reporting period.

Gain or loss on net monetary position

31.13 In a period of inflation, an entity holding an excess of monetary assets over monetary liabilities loses purchasing power, and an entity with an excess of monetary liabilities over monetary assets **gains** purchasing power, to the extent the assets and liabilities are not linked to a price level. An entity shall include in **profit or loss** the gain or loss on the net monetary position. An entity shall offset the adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 31.7 against the gain or loss on net monetary position.

Economies ceasing to be hyperinflationary

31.14 When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this section, it shall treat the amounts expressed in the **presentation currency** at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

Disclosures

31.15 An entity to which this section applies shall disclose the following:

(a) the fact that financial statements and other prior period data have been restated for changes in the general purchasing power of the functional currency;

(b) the identity and level of the price index at the reporting date and changes during the current reporting period and the previous reporting period; and

(c) amount of gain or loss on monetary items.

Section 32
Events after the End of the Reporting Period

Scope of this section

32.1 This section defines events after the end of the **reporting period** and sets out principles for recognising, measuring and disclosing those events.

Events after the end of the reporting period defined

32.2 Events after the end of the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the **financial statements** are authorised for issue. There are two types of events:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period), and

(b) those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period).

32.3 Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of **profit or loss** or other selected financial information.

Recognition and measurement

Adjusting events after the end of the reporting period

32.4 An entity shall adjust the amounts recognised in its financial statements, including related disclosures, to reflect adjusting events after the end of the reporting period.

32.5 The following are examples of adjusting events after the end of the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) the settlement after the end of the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised **provision** related to this court case in accordance with Section 21 *Provisions and Contingencies* or recognises a new provision. The entity does not merely disclose a **contingent liability**. Instead, the settlement provides additional evidence to be considered in determining the provision that should be recognised at the end of the reporting period in accordance with Section 21.

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

(i) the bankruptcy of a customer that occurs after the end of the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the entity needs to adjust the **carrying amount** of the trade receivable; and

(ii) the sale of **inventories** after the end of the reporting period may give evidence about their selling price at the end of the reporting period for the purpose of assessing impairment at that date.

(c) the determination after the end of the reporting period of the cost of assets purchased,or the proceeds from assets sold, before the end of the reporting period.

(d) the determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the entity had a legal or **constructive obligation** at the end of the reporting period to make such payments as a result of events before that date (see Section 28 *Employee Benefits*).

(e) the discovery of fraud or **errors** that show that the financial statements are incorrect.

Non-adjusting events after the end of the reporting period

32.6 An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.

32.7 Examples of non-adjusting events after the end of the reporting period include:

(a) a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Consequently, 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 end of the reporting period, although it may need to give additional disclosure in accordance with paragraph 32.10.

(b) an amount that becomes receivable as a result of a favourable judgement or settlement of a court case after the **reporting date** but before the financial statements are authorised for issue. This would be a **contingent asset** at the reporting date (see paragraph 21.13) and disclosure may be required by paragraph 21.16. However, agreement on the amount of damages for a judgement that was reached before the reporting date, but was not previously recognised because the amount could not be measured reliably, may constitute an adjusting event.

Dividends

32.8 If an entity declares dividends to holders of its **equity** instruments after the end of the reporting period, the entity shall not recognise those dividends as a **liability** at the end of the reporting period. The amount of the dividend may be presented as a segregated component of retained earnings at the end of the reporting period.

Disclosure

Date of authorisation for issue

32.9 An entity shall 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 issue, the entity shall disclose that fact.

Non-adjusting events after the end of the reporting period

32.10 An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period:

(a) the nature of the event; and

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

32.11 The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure; the disclosures will reflect information that becomes known after the end of the reporting period but before the financial statements are authorised for issue:

(a) a major **business combination** or disposal of a major **subsidiary**;

(b) announcement of a plan to discontinue an operation;

(c) major purchases of assets, disposals or plans to dispose of assets, or expropriation of major assets by government;

(d) the destruction of a major production plant by a fire;

(e) announcement, or commencement of the implementation, of a major restructuring;

(f) issues or repurchases of an entity's debt or equity instruments;

(g) abnormally large changes in asset prices or foreign exchange rates;

(h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities;

(i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and

(j) commencement of major litigation arising solely out of events that occurred after the end of the reporting period.

Section 33
Related Party Disclosures

Scope of this section

33.1 This section requires an entity to include in its **financial statements** the disclosures necessary to draw attention to the possibility that its **financial position** and **profit or loss** have been affected by the existence of **related parties** and by transactions and outstanding balances with such parties.

Related party defined

33.2 A **related party** is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).

(a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) is a member of the key management personnel of the reporting entity or of a **parent** of the reporting entity;

(ii) has **control** or **joint control** over the reporting entity; or

(iii) has significant influence over the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) the entity and the reporting entity are members of the same **group** (which means that each parent, **subsidiary** and fellow subsidiary is related to the others).

(ii) one entity is an **associate** or **joint venture** of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) both entities are joint ventures of the same third entity.

(iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) the entity is a **post-employment benefit plan** for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) the entity is controlled or jointly controlled by a person identified in (a).

(vii) the entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

(viii) a person identified in (a)(ii) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

33.3 In considering each possible related party relationship, an entity shall assess the substance of the relationship and not merely the legal form.

33.4 In the context of this Standard, the following are not necessarily related parties:

(a) two entities simply because they have a director or other member of key management personnel in common.

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

(c) any of the following simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process):

(i) providers of finance;

(ii) trade unions;

(iii) public utilities; or

(iv) government departments and agencies.

(d) a 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.

Disclosures

Disclosure of parent-subsidiary relationships

33.5 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been **related party transactions**. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

33.6 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. Compensation includes all employee benefits (as defined in Section 28 *Employee Benefits*) including those in the form of share-based payment (see Section 26 *Share-based Payment*). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (for example by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of goods or services provided to the entity.

33.7 An entity shall disclose key management personnel compensation in total.

Disclosure of related party transactions

33.8 A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged. Examples of related party transactions that are common to Private Entities include, but are not limited to:

(a) transactions between an entity and its principal **owner**(s);

(b) transactions between an entity and another entity when both entities are under the common control of a single entity or person; and

(c) transactions in which an entity or person that controls the reporting entity incurs **expenses** directly that otherwise would have been borne by the reporting entity.

33.9 If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall 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 uncollectible receivables 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.

Such transactions could include purchases, sales, or transfers of goods or services; **leases**; guarantees; and settlements by the entity on behalf of the related party or vice versa.

33.10 An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories:

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

(b) entities over which the entity has control, joint control or significant influence;

(c) key management personnel of the entity or its parent (in the aggregate); and

(d) other related parties.

33.11 An entity is exempt from the disclosure requirements of paragraph 33.9 in relation to:

(a) a **state** (a national, regional or local government) that has control, joint control or significant influence over the reporting entity; and

(b) another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity.

However, the entity must still disclose a parent-subsidiary relationship as required by paragraph 33.5.

33.12 The following are examples of transactions that shall be disclosed if they are with a related party:

(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;

(i) settlement of **liabilities** on behalf of the entity or by the entity on behalf of another party; and

(j) participation by a parent or subsidiary in a **defined benefit plan** that shares risks between group entities.

33.13 An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.

33.14 An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Section 34
Specialised Activities

Scope of this section

34.1 This section provides guidance on financial reporting by Private Entities involved in three types of specialised activities—agriculture, extractive activities, and service concessions.

Agriculture

34.2 An entity using this Standard that is engaged in **agricultural activity** shall determine its accounting policy for each class of its **biological assets** as follows:

(a) the entity shall use the **fair value** model in paragraphs 34.4–34.7 for those biological assets for which fair value is readily determinable without undue cost or effort; and

(b) the entity shall use the cost model in paragraphs 34.8–34.10 for all other biological assets.

Recognition

34.3 An entity shall recognise a biological asset or **agricultural produce** when, and only when:

(a) the entity controls the **asset** as a result of past events;

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

(c) the fair value or cost of the asset can be measured reliably without undue cost or effort.

Measurement – fair value model

34.4 An entity shall measure a biological asset on initial **recognition** and at each **reporting date** at its **fair value less costs to sel**l. Changes in fair value less costs to sell shall be recognised in **profit or loss**.

34.5 Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such **measurement** is the cost at that date when applying Section 13 *Inventories* or another applicable section of this Standard.

34.6 In determining fair value, an entity shall consider the following:

(a) if an **active market** exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an entity has access to different active markets, the entity shall use the price existing in the market that it expects to use.

(b) if an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:

(i) the most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the end of the **reporting period**;

(ii) market prices for similar assets with adjustment to reflect differences; and

(iii) sector benchmarks such as the value of an orchard expressed per export tray,bushel, or hectare, and the value of cattle expressed per kilogram of meat.

(c) in some cases, the information sources listed in (a) or (b) may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.

(d) in some circumstances, fair value may be readily determinable without undue cost or effort even though market determined prices or values are not available for a biological asset in its present condition. An entity shall consider whether the **present value** of expected net **cash flows** from the asset discounted at a current market determined rate results in a reliable measure of fair value.

Disclosures – fair value model

34.7 An entity shall disclose the following with respect to its biological assets measured at fair value:

(a) a description of each class of its biological assets.

(b) the methods and significant assumptions applied in determining the fair value of each category of agricultural produce at the point of harvest and each category of biological assets.

(c) a reconciliation of changes in the **carrying amount** of biological assets between the beginning and the end of the current period. The reconciliation shall include:

(i) the **gain** or loss arising from changes in fair value less costs to sell;

(ii) increases resulting from purchases;

(iii) decreases resulting from harvest;

(iv) increases resulting from **business combinations**;

(v) net exchange differences arising on the translation of **financial statements** into a different **presentation currency**, and on the translation of a **foreign operation** into the presentation currency of the reporting entity; and

(vi) other changes.

This reconciliation need not be presented for prior periods.

Measurement – cost model

34.8 The entity shall measure at cost less any accumulated **depreciation** and any accumulated **impairment** losses those biological assets whose fair value is not readily determinable without undue cost or effort.

34.9 The entity shall measure agricultural produce harvested from its biological assets at fair value less estimated costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 or other sections of this Standard.

Disclosures – cost model

34.10 An entity shall disclose the following with respect to its biological assets measured using the cost model:

(a) a description of each class of its biological assets;

(b) an explanation of why fair value cannot be measured reliably without undue cost or effort;

(c) the depreciation method used;

(d) the useful lives or the depreciation rates used; and

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

Exploration for and evaluation of mineral resources

34.11 An entity using this Standard that is engaged in the exploration for, or evaluation of, mineral resources shall determine an accounting policy that specifies which expenditures are recognised as exploration and evaluation assets in accordance with paragraph 10.4 and apply the policy consistently. An entity is exempt from applying paragraph 10.5 to its **accounting policies** for the recognition and measurement of exploration and evaluation assets.

34.11A The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

(a) acquisition of rights to explore;

(b) topographical, geological, geochemical and geophysical studies;

(c) exploratory drilling;

(d) trenching;

(e) sampling; and

(f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets.

34.11B Exploration and evaluation assets shall be measured on initial recognition at cost. After initial recognition, an entity shall apply Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill* to the exploration and evaluation assets according to the nature of the assets acquired subject to paragraphs 34.11D–34.11F. If an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.

34.11C Exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its **recoverable amount**. An entity shall measure, present and disclose any resulting impairment loss in accordance with Section 27 *Impairment of Assets* , except as provided by paragraph 34.11F.

34.11D For the purposes of exploration and evaluation assets only, paragraph 34.11E shall be applied instead of paragraphs 27.7–27.10 when identifying an exploration and evaluation asset that may be impaired. Paragraph 34.11E uses the term ‘assets’ but applies equally to separate exploration and evaluation assets or a **cash-generating unit**.

34.11E One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation assets for impairment (the list is not exhaustive):

(a) the period for which the entity has the right to explore in the specific area has expired during the period, or will expire in the near future, and is not expected to be renewed;

(b) substantive expenditure on further exploration for, and evaluation of, mineral resources in the specific area is neither budgeted nor planned;

(c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area; or

(d) sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

The entity shall perform an impairment test, and recognise any impairment loss, in accordance with Section 27.

34.11F An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment.

Service concession arrangements

34.12 A **service concession arrangement** is an arrangement whereby a government or other public sector body (the grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. In those arrangements, the grantor controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.

34.13 There are two principal categories of service concession arrangements:

(a) in one, the operator receives a **financial asset**—an unconditional contractual right to receive a specified or determinable amount of cash or another financial asset from the government in return for constructing or upgrading a public sector asset, and then operating and maintaining the asset for a specified period of time. This category includes guarantees by the government to pay for any shortfall between amounts received from users of the public service and specified or determinable amounts.

(b) in the other, the operator receives an **intangible asset**—a right to charge for use of a public sector asset that it constructs or upgrades and then operates and maintains for a specified period of time. A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service.

Sometimes, a single contract may contain both types: to the extent that the government has given an unconditional guarantee of payment for the construction of the public sector asset, the operator has a financial asset; to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset.

Accounting – financial asset model

34.14 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The operator shall measure the financial asset at fair value. Thereafter, it shall follow Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues* in accounting for the financial asset.

Accounting – intangible asset model

34.15 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. The operator shall initially measure the intangible asset at fair value. Thereafter, it shall follow Section 18 in accounting for the intangible asset.

Operating revenue

34.16 The operator of a service concession arrangement shall recognise, measure and disclose **revenue** in accordance with Section 23 *Revenue* for the services it performs.

Section 35
Transition to the HKFRS for Private Entities

Scope of this section

35.1 This section applies to a **first-time adopter of the *HKFRS for Private Entities***, regardless of whether its previous accounting framework was **full HKFRSs** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards, or another framework such as the local income tax basis.

35.2 An entity that has applied the *HKFRS for Private Entities* in a previous **reporting period**, but whose most recent previous annual **financial statements** did not contain an explicit and unreserved statement of compliance with the *HKFRS for Private Entities*, must either apply this section or apply the *HKFRS for Private Entities* retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors* as if the entity had never stopped applying the *HKFRS for Private Entities*. When such an entity does not elect to apply this section, it is still required to apply the disclosure requirements in paragraph 35.12A in addition to the disclosure requirements in Section 10.

First-time adoption

35.3 A first-time adopter of the *HKFRS for Private Entities* shall apply this section in its first financial statements that conform to this Standard.

35.4 An entity's first financial statements that conform to this Standard are the first annual financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with the *HKFRS for Private Entities*. Financial statements prepared in accordance with this Standard are an entity's first such financial statements if, for example, the entity:

(a) did not present financial statements for previous periods;

(b) presented its most recent previous financial statements under national requirements that are not consistent with this Standard in all respects; or

(c) presented its most recent previous financial statements in conformity with **full HKFRSs**.

35.5 Paragraph 3.17 defines a complete set of financial statements.

35.6 Paragraph 3.14 requires an entity to disclose, in a complete set of financial statements, comparative information in respect of the previous comparable period for all monetary amounts presented in the financial statements, as well as specified comparative narrative and descriptive information. An entity may present comparative information in respect of more than one comparable prior period. Consequently, an entity's **date of transition to the *HKFRS for Private Entities*** is the beginning of the earliest period for which the entity presents full comparative information in accordance with this Standard in its first financial statements that conform to this Standard.

Procedures for preparing financial statements at the date of transition

35.7 Except as provided in paragraphs 35.9–35.11, an entity shall on its date of transition to the *HKFRS for Private Entities* (ie the beginning of the earliest period presented):

(a) recognise all **assets** and **liabilities** whose **recognition** is required by the *HKFRS for Private Entities*;

(b) not recognise items as assets or liabilities if this Standard does not permit such recognition;

(c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of **equity**, but are a different type of asset, liability or component of equity under this Standard; and

(d) apply this Standard in measuring all recognised assets and liabilities.

35.8 The **accounting policies** that an entity uses on adoption of this Standard may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this Standard. Consequently, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this Standard.

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) **derecognition** of **financial assets** and **financial liabilities**. Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition shall not be recognised upon adoption of the *HKFRS for Private Entities*. Conversely, for financial assets and liabilities that would have been derecognised under the *HKFRS for Private Entities* in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose (a) to derecognise them on adoption of the *HKFRS for Private Entities* or (b) to continue to recognise them until disposed of or settled.

(b) hedge accounting. An entity shall not change its hedge accounting before the date of transition to the *HKFRS for Private Entities* for the hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Section 12 *Other Financial Instrument Issues*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Section 12.

(c) accounting estimates.

(d) **discontinued operations**.

(e) measuring **non-controlling interests**. The requirements of paragraph 5.6 to allocate **profit or loss** and **total comprehensive income** between non-controlling interest and **owners** of the parent shall be applied prospectively from the date of transition to the *HKFRS for Private Entities* (or from such earlier date as this Standard is applied to restate **business combinations**—see paragraph 35.10(a)).

(f) government loans. A first-time adopter shall apply the requirements in Section 11 *Basic Financial Instruments*, Section 12 and Section 24 *Government Grants* prospectively to government loans existing at the date of transition to this Standard. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan on a basis that is consistent with this Standard, it shall use its previous GAAP **carrying amount** of the loan at the date of transition to this Standard as the carrying amount of the loan at that date and shall not recognise the benefit of any government loan at a below-market rate of interest as a **government grant**.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

(a) business combinations. A first-time adopter may elect not to apply Section 19 *Business Combinations and Goodwill* to business combinations that were effected before the date of transition to this Standard. However, if a first-time adopter restates any business combination to comply with Section 19, it shall restate all later business combinations.

(b) **share-based payment transactions**. A first-time adopter is not required to apply Section 26 *Share-based Payment* to equity instruments that were granted before the date of transition to this Standard, or to liabilities arising from share-based payment transactions that were settled before the date of transition to this Standard.

(c) **fair value** as deemed cost. A first-time adopter may elect to measure an item of **property, plant and equipment**, an **investment property**, or an **intangible asset** on the date of transition to this Standard at its fair value and use that fair value as its deemed cost at that date.

(d) revaluation as deemed cost. A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment, an investment property, or an intangible asset at, or before, the date of transition to this Standard as its deemed cost at the revaluation date.

(da) event-driven fair value **measurement** as deemed cost. A first-time adopter may have established a deemed cost in accordance with its previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event, for example, a valuation of the business, or parts of the business, for the purposes of a planned sale. If the measurement date:

(i) is at or before the date of transition to this Standard, the entity may use such event-driven fair value measurements as deemed cost at the date of that measurement.

(ii) is after the date of transition to this Standard, but during the periods covered by the first financial statements that conform to this Standard, the event-driven fair value measurements may be used as deemed cost when

the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or, if appropriate, another category of equity) at the measurement date. At the date of transition to this Standard, the entity shall either establish the deemed cost by applying the criteria in paragraph 35.10(c)–(d) or measure those assets and liabilities in accordance with the other requirements in this section.

(e) cumulative translation differences. Section 30 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity. A first-time adopter may elect to deem the cumulative translation differences for all **foreign operations** to be zero at the date of transition to the *HKFRS for Private Entities* (ie a 'fresh start').

(f) **separate financial statements**. When an entity prepares separate financial statements, paragraph 9.26 requires it to account for its investments in **subsidiaries**, **associates**, and jointly controlled entities either:

(i) at cost less **impairment**;

(ii) at fair value with changes in fair value recognised in profit or loss; or

(iii) using the equity method following the procedures in paragraph 14.8.

If a first-time adopter measures such an investment at cost, it shall measure that investment at one of the following amounts at the date of transition:

(i) cost determined in accordance with Section 9 *Consolidated and Separate Financial Statements*; or

(ii) deemed cost, which shall be either fair value at the date of transition to the *HKFRS for Private Entities* or previous GAAP carrying amount on that date.

(g) **compound financial instruments**. Paragraph 22.13 requires an entity to split a compound financial instrument into its liability and equity components at the date of issue. A first-time adopter need not separate those two components if the liability component is not outstanding at the date of transition to this Standard.

(h) deferred income tax. A first-time adopter may apply Section 29 *Income Tax* prospectively from the date of transition to the *HKFRS for Private Entities*.

(i) **service concession arrangements**. A first-time adopter is not required to apply paragraphs 34.12–34.16 to service concession arrangements entered into before the date of transition to this Standard.

(j) extractive activities. A first-time adopter using full cost accounting under previous GAAP may elect to measure oil and gas assets (those used in the exploration, evaluation, development or production of oil and gas) on the date of transition to the *HKFRS for Private Entities* at the amount determined under the entity's previous GAAP. The entity shall test those assets for impairment at the date of transition to this Standard in accordance with Section *27 Impairment of Assets*.

(k) arrangements containing a lease. A first-time adopter may elect to determine whether an arrangement existing at the date of transition to the *HKFRS for Private Entities* contains a lease (see paragraph 20.3) on the basis of facts and circumstances existing at that date, instead of when the arrangement was entered into.

(l) decommissioning liabilities included in the cost of property, plant and equipment. Paragraph 17.10(c) states that the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce **inventories** during that period. A first-time adopter may elect to measure this component of the cost of an item of property, plant and equipment at the date of transition to the *HKFRS for Private Entities*, instead of on the date(s) when the obligation initially arose.

(m) operations subject to rate regulation. If a first-time adopter holds items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation (ie to provide goods or services to customers at prices/rates established by an authorised body) it may elect to use the previous GAAP carrying amount of those items at the date of transition to this Standard as their deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. The entity shall test those assets for impairment at the date of transition to this Standard in accordance with Section 27.

(n) **severe hyperinflation.** If a first-time adopter has a **functional currency** that was subject to severe hyperinflation:

(i) if its date of transition to this Standard is on, or after, the **functional currency normalisation date**, the entity may elect to measure all assets and liabilities held before the functional currency normalisation date at fair value on the date of transition to this Standard and use that fair value as the deemed cost of those assets and liabilities at that date; and

(ii) if the functional currency normalisation date falls within a twelve month comparative period, an entity may use a comparative period of less than twelve months, provided that a complete set of financial statements (as required by paragraph 3.17) is provided for that shorter period.

35.11 If it is **impracticable** for an entity to make one or more of the adjustments required by paragraph 35.7 at the date of transition, the entity shall apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify which amounts in the financial statements have not been restated. If it is impracticable for an entity to provide any of the disclosures required by this Standard, including those for comparative periods, the omission shall be disclosed.

Disclosures

Explanation of transition to the *HKFRS for Private Entities*

35.12 An entity shall explain how the transition from its previous financial reporting framework to this Standard affected its reported **financial position**, financial **performance** and **cash flows**.

35.12A An entity that has applied the *HKFRS for Private Entities* in a previous period, as described in paragraph 35.2, shall disclose:

(a) the reason it stopped applying the *HKFRS for Private Entities*;

(b) the reason it is resuming the application of the *HKFRS for Private Entities*; and

(c) whether it has applied this section or has applied the *HKFRS for Private Entities* retrospectively in accordance with Section 10.

Reconciliations

35.13 To comply with paragraph 35.12, an entity's first financial statements prepared using this Standard shall include:

(a) a description of the nature of each change in accounting policy;

(b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this Standard for both of the following dates:

(i) the date of transition to this Standard, and

(ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.

(c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this Standard for the same period.

35.14 If an entity becomes aware of **errors** made under its previous financial reporting framework, the reconciliations required by paragraph 35.13(b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.

35.15 If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this Standard.

Appendix A

Effective date and transition

This Appendix is an integral part of the Standard.

A1 *2015 Amendments to the HKFRS for Private Entities*, issued in September 2015, amended paragraphs 1.3, 2.22, 2.47, 2.49–2.50, 4.2, 4.12, 5.4–5.5, 6.2–6.3, 9.1–9.3, 9.16, 9.18, 9.24–9.26, 9.28, 11.2, 11.4, 11.7, 11.9, 11.11, 11.13–11.15, 11.27, 11.32, 11.44, 12.3, 12.8–12.9, 12.23, 12.25, 12.29, 14.15, 15.21, 16.10, 17.5–17.6, 17.15, 17.31–17.32, 18.8, 18.20, 19.2, 19.11, 19.14–19.15, 19.23, 19.25–19.26, 20.1, 20.3, 21.16, 22.8–22.9, 22.15, 22.17–22.18, 26.1, 26.9, 26.12, 26.16–26.17, 26.22, 27.1, 27.6, 27.14, 27.30–27.31, 28.30, 28.41, 28.43, 30.1, 30.18, 31.8–31.9 33.2, 34.7, 34.10–34.11, 35.2, 35.9–35.11 and the glossary of terms, revised Section 29 and added paragraphs 1.7, 2.14A–2.14D, 9.3A–9.3C, 9.23A, 10.10A, 11.9A–11.9B, 17.15A–17.15D, 17.33, 22.3A, 22.15A–22.15C, 22.18A–22.18B, 22.20, 26.1A–26.1B, 34.11A–34.11F, 35.12A and A2–A3. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2017. Amendments to Sections 2–34 shall be applied retrospectively in accordance with Section 10 except as stated in paragraph A2. Earlier application of *2015 Amendments to the HKFRS for Private Entities* is permitted. If an entity applies *2015 Amendments to the HKFRS for Private Entities* for an earlier period it shall disclose that fact.

A2 If it is impracticable for an entity to apply any new or revised requirements in the amendments to Sections 2–34 retrospectively, the entity shall apply those requirements in the earliest period for which it is practicable to do so. In addition an entity:

(a) may elect to apply the revised Section 29 prospectively from the beginning of the period in which it first applies *2015 Amendments to the HKFRS for Private Entities*.

(b) shall apply the amendments to paragraph 19.11 prospectively from the beginning of the period in which it first applies *2015 Amendments to the HKFRS for Private Entities*. This paragraph is only applicable if the entity has business combinations within the scope of Section 19.

(c) shall apply the amendments to paragraphs 2.49–2.50, 5.4, 17.15, 27.6, 27.30–27.31 and 31.8–31.9 and new paragraphs 10.10A, 17.15A–17.15D and 17.33 prospectively from the beginning of the period it first applies *2015 Amendments to the HKFRS for Private Entities*. These paragraphs are only applicable if the entity applies the revaluation model to any classes of property, plant and equipment in accordance with paragraph 17.15.

A3 The entity shall identify which amounts in the financial statements have not been restated as a result of applying paragraph A2.

Appendix B

This Appendix is an integral part of the Standard.

Glossary of terms

accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
accounting profit	Profit or loss for a period before deducting tax expense.
accrual basis of accounting	The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
accumulating compensated absences	Compensated absences that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
active market	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
agricultural activity	The management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets.
agricultural produce	The harvested product of the entity's biological assets.
amortisation	The systematic allocation of the depreciable amount of an asset over its useful life.
amortised cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.
asset	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.
associate	An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.
biological asset	A living animal or plant.

borrowing costs — Interest and other costs incurred by an entity in connection with the borrowing of funds.

business — An integrated set of activities and assets conducted and managed for the purpose of providing:

(a) a return to investors, or

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

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

business combination — The bringing together of separate entities or businesses into one reporting entity.

carrying amount — The amount at which an asset or liability is recognised in the statement of financial position.

cash — Cash on hand and demand deposits.

cash equivalent — Short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

cash flows — Inflows and outflows of cash and cash equivalents.

cash-generating unit — The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

cash-settled share-based payment transaction — A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity.

change in accounting estimate — An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

class of assets — A grouping of assets of a similar nature and use in an entity's operations.

close members of the family of a person

Those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity, including:

(a) that person's children and spouse or domestic partner;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

component of an entity

Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

compound financial instrument

A financial instrument that, from the issuer's perspective, contains both a liability and an equity element.

consolidated financial statements

The financial statements of a parent and its subsidiaries presented as those of a single economic entity.

construction contract

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.

constructive obligation

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.

contingent asset

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.

contingent liability

(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.

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

current tax — The amount of income tax payable (recoverable) in respect of the taxable profit (tax loss) for the current period or past periods.

date of transition to the *HKFRS for Private Entities* — The beginning of the earliest period for which an entity presents full comparative information under the *HKFRS for Private Entities* in its first financial statements that comply with the *HKFRS for Private Entities.*

deductible temporary differences — Temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

deferred tax — Income tax payable (recoverable) in respect of the taxable profit (tax loss) of future periods as a result of past transactions or events.

deferred tax assets — The amounts of income tax recoverable in future periods in respect of:

(a) deductible temporary differences;

(b) the carryforward of unused tax losses; and

(c) the carryforward of unused tax credits.

deferred tax liabilities — The amounts of income tax payable in future periods in respect of taxable temporary differences.

defined benefit liability — The present value of the defined benefit obligation at the reporting date minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

defined benefit obligation (present value of) — The present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

defined benefit plans — Post-employment benefit plans other than defined contribution plans.

defined contribution plans Post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

depreciable amount The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value.

depreciation The systematic allocation of the depreciable amount of an asset over its useful life.

derecognition The removal of a previously recognised asset or liability from an entity's statement of financial position.

development 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 before the start of commercial production or use.

discontinued operation A component of an entity that either has been disposed of, or is held for sale, and

(a) represents a separate major line of business or geographical area of operations,

(b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or

(c) is a subsidiary acquired exclusively with a view to resale.

effective interest method A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

effective interest rate The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

effectiveness of a hedge The degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

employee benefits All forms of consideration given by an entity in exchange for service rendered by employees.

equity	The residual interest in the assets of the entity after deducting all its liabilities.
equity-settled share-based payment transaction	A share-based payment transaction in which the entity: (a) receives goods or services as consideration for its own equity instruments (including shares or share options); or (b) receives goods or services but has no obligation to settle the transaction with the supplier.
errors	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.
expenses	Decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.
true and fair view	Faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.
fair value	The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.
fair value less costs to sell	The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
finance lease	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 lease that is not a finance lease is an operating lease.

financial asset

Any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

  (i) to receive cash or another financial asset from another entity, or

  (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and:

  (i) under which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or

  (ii) that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial instrument

A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

financial liability

Any liability that is:

(a) a contractual obligation:

  (i) to deliver cash or another financial asset to another entity, or

  (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and:

  (i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or

  (ii) will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial position	The relationship of the assets, liabilities and equity of an entity as reported in the statement of financial position.
financial statements	Structured representation of the financial position, financial performance and cash flows of an entity.
financing activities	Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.
firm commitment	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.
first-time adopter of the HKFRS for Private Entities	An entity that presents its first annual financial statements that conform to the *HKFRS for Private Entities*, regardless of whether its previous accounting framework was full HKFRSs or another set of accounting standards.
forecast transaction	An uncommitted but anticipated future transaction.
foreign operation	An entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.
full HKFRSs	Hong Kong Financial Reporting Standards (HKFRSs) other than the *HKFRS for Private Entities*.
functional currency	The currency of the primary economic environment in which the entity operates.
functional currency normalisation date	The date when an entity's functional currency no longer has either, or both, of the two characteristics of severe hyperinflation, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.
funding (of post-employment benefits)	Contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid.
gains	Increases in economic benefits that meet the definition of income but are not revenue.
general purpose financial statements	Financial statements directed to the general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.
going concern	An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.
goodwill	Future economic benefits arising from assets that are not capable of being individually identified and separately recognised.

government grants 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.

grant date The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date, the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

gross investment in a lease The aggregate of:

(a) the minimum lease payments receivable by the lessor under a finance lease, and

(b) any unguaranteed residual value accruing to the lessor.

group A parent and all its subsidiaries.

hedged item For the purpose of special hedge accounting by Private Entities under Section 12 of this Standard, a hedged item is:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction;

(c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or

(d) foreign exchange risk in a net investment in a foreign operation.

hedging instrument

For the purpose of special hedge accounting by Private Entities under Section 12 of this Standard, a hedging instrument is a financial instrument that meets all of the following terms and conditions:

(a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 12.17 that is designated as the hedged risk;

(b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on);

(c) its notional amount is equal to the designated amount of the principal or notional amount of the hedged item;

(d) it has a specified maturity date not later than:

  (i) the maturity of the financial instrument being hedged;

  (ii) the expected settlement of the commodity purchase or sale commitment; or

  (iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

An entity that chooses to apply HKAS 39 in accounting for financial instruments shall apply the definition of hedging instrument in that standard rather than this definition.

highly probable

Significantly more likely than probable.

Hong Kong Financial Reporting Standards (HKFRSs)

Standards and Interpretations adopted by the Hong Kong Institute of Certified Public Accountants (HKICPA). They comprise:

(a) Hong Kong Financial Reporting Standards;

(b) Hong Kong Accounting Standards; and

(c) Interpretations.

impairment (loss)

The amount by which the carrying amount of an asset exceeds

(a) in the case of inventories, its selling price less costs to complete and sell; or

(b) in the case of other non-financial assets, its recoverable amount.

impracticable

Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

imputed rate of interest

The more clearly determinable of either:

(a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or

(b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

income

Increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from owners.

income statement

A financial statement that presents all items of income and expense recognised in a reporting period, excluding the items of other comprehensive income.

income tax

All domestic and foreign taxes that are based on taxable profits. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distribution to the reporting entity.

insurance contract

A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

intangible asset

An identifiable non-monetary asset without physical substance. Such an asset is identifiable when it:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

interest rate implicit in the lease

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 sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.

interim financial report

A financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period.

interim period

A financial reporting period shorter than a full financial year.

intrinsic value

The difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of CU15, on a share with a fair value of CU20, has an intrinsic value of CU5.

inventories

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.

investing activities

The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

investment property

Property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, instead of for:

(a) use in the production or supply of goods or services or for administrative purposes, or

(b) sale in the ordinary course of business.

joint control

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

joint venture

A contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.

jointly controlled entity	A joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.
lease	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.
lessee's incremental borrowing rate of interest	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.
liability	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.
loans payable	Financial liabilities other than short-term trade payables on normal credit terms.
market vesting condition	A condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price of the entity's equity instruments, such as attaining a specified share price or a specified amount of intrinsic value of a share option, or achieving a specified target that is based on the market price of the entity's equity instruments relative to an index of market prices of equity instruments of other entities.
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
measurement	The process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the statement of financial position and statement of comprehensive income.
minimum lease payments	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: (a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) for a lessor, any residual value guaranteed to the lessor by:

(i) the lessee;

(ii) a party related to the lessee; or

(iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

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 for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

monetary items — Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

multi-employer (benefit) plans — Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) pool the assets contributed by various entities that are not under common control, and

(b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.

net investment in a lease — The gross investment in a lease discounted at the interest rate implicit in the lease.

non-controlling interest — The equity in a subsidiary not attributable, directly or indirectly, to a parent.

notes (to financial statements) — Notes contain information in addition to that presented in the statement of financial position, statement of comprehensive income, income statement (if presented), combined statement of income and retained earnings (if presented), statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.

notional amount — The quantity of currency units, shares, bushels, pounds or other units specified in a financial instrument contract.

objective of financial statements	To provide information about the financial position, performance and cash flows of an entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
onerous contract	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	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a finance lease.
other comprehensive income	Items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by this Standard.
owners	Holders of instruments classified as equity.
parent	An entity that has one or more subsidiaries.
performance	The relationship of the income and expenses of an entity, as reported in the statement of comprehensive income.
plan assets (of an employee benefit plan)	Assets held by a long-term employee benefit fund and qualifying insurance policies.
post-employment benefits	Employee benefits (other than termination benefits) that are payable after the completion of employment.
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.
present value	A current estimate of the present discounted value of the future net cash flows in the normal course of business.
presentation currency	The currency in which the financial statements are presented.
private entities	Entities that: (a) do not have public accountability, and (b) publish general purpose financial statements for external users. An entity has public accountability if:

(a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

probable — More likely than not.

profit or loss — The total of income less expenses, excluding the components of other comprehensive income.

projected unit credit method — An actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method).

property, plant and equipment — Tangible assets that:

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

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

prospective application (of a change in accounting policy) — Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed.

provision — A liability of uncertain timing or amount.

prudence — The inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

public accountability — An entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

publicly traded (debt or equity instruments)

Traded, or in process of being issued for trading, in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

recognition

The process of incorporating in the statement of financial position or statement of comprehensive income an item that meets the definition of an asset, liability, equity, income or expense and that satisfies the following criteria:

(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.

recoverable amount

The higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.

related party

A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity):

(a) A person or a close member of that person's family is related to a reporting entity if that person:

  (i) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity;

  (ii) has control or joint control over the reporting entity; or

  (iii) has significant influence over the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

  (i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

  (ii) one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

  (iii) both entities are joint ventures of ~~a~~ the same third entity.

  (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity.

  (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

  (vi) the entity is controlled or jointly controlled by a person identified in (a).

  (vii) the entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

  (viii) a person identified in (a)(ii) has significant influence over

the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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

relevance — The quality of information that allows it to influence the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

reliability — The quality of information that makes it free from material error and bias and represent faithfully that which it either purports to represent or could reasonably be expected to represent.

reporting date — The end of the latest period covered by financial statements or by an interim financial report.

reporting period — The period covered by financial statements or by an interim financial report.

research — Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

residual value (of an asset) — The estimated amount that an entity would currently obtain from disposal of an 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.

retrospective application (of a change in accounting policy) — Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

revenue — 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.

separate financial statements — Those presented by an entity, in which the entity could elect, in accordance with paragraphs 9.25–9.26, to account for its investments in subsidiaries, jointly-controlled entities and associates either at cost less impairment, at fair value with changes in fair value recognised in profit or loss or using the equity method following the procedures in paragraph 14.8.

service concession arrangement — An arrangement whereby a government or other public sector body contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals.

severe hyperinflation

The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:

(a) a reliable general price index is not available to all entities with transactions and balances in the currency; and

(b) exchangeability between the currency and a relatively stable foreign currency does not exist.

share-based payment arrangement

An agreement between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive:

(a) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity; or

(b) equity instruments (including shares or share options) of the entity or another group entity

provided the specified vesting conditions, if any, are met.

share-based payment transaction

A transaction in which the entity:

(a) receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement; or

(b) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.

state

A national, regional or local government.

state (employee benefit) plan

Employee benefit plans established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.

statement of cash flows

A financial statement that provides information about the changes in cash and cash equivalents of an entity for a period, showing separately changes during the period from operating, investing and financing activities.

statement of changes in equity

A financial statement that presents the profit or loss for a period, items of income and expense recognised directly in equity for the period, the effects of changes in accounting policy and corrections of errors recognised in the period, and (depending on the format of the statement of changes in equity chosen by the entity) the amounts of transactions with owners acting in their capacity as

	owners during the period.
statement of comprehensive income	A financial statement that presents all items of income and expense recognised in a period, including those items recognised in determining profit or loss (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
statement of financial position	A financial statement that presents the relationship of an entity's assets, liabilities and equity as of a specific date (also called the balance sheet).
statement of income and retained earnings	A financial statement that presents the profit or loss and changes in retained earnings for a period.
subsidiary	An entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).
tax base	Tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.
tax expense	The aggregate amount included in total comprehensive income or equity for the reporting period in respect of current tax and deferred tax.
taxable profit (tax loss)	The profit (loss) for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the taxation authorities. Taxable profit equals taxable income less amounts deductible from taxable income.
taxable temporary differences	Temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.
temporary differences	Differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.
termination benefits	Employee benefits payable as a result of either: (a) an entity's decision to terminate an employee's employment before the normal retirement date, or (b) an employee's decision to accept voluntary redundancy in exchange for those benefits.
timing differences	Income or expenses that are recognized in profit or loss in one period but, under tax laws or regulations, are included in taxable income in a different period.

timeliness	Providing the information in financial statements within the decision time frame.
total comprehensive income	The change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners (equal to the sum of profit or loss and other comprehensive income).
transaction costs (financial instruments)	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.
treasury shares	An entity's own equity instruments, held by the entity or other members of the consolidated group.
understandability	The quality of information in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.
useful life	The period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
value in use	The present value of the future cash flows expected to be derived from an asset or cash-generating unit.
venturer	A party to a joint venture that has joint control over that joint venture.
vest	Become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.
vested benefits	Benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.
vesting conditions	The conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. Vesting conditions are either service conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time). A performance condition might include a market vesting condition.

vesting period	The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Derivation table

The *HKFRS for Private Entities* was developed by:

(a) extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from full HKFRSs (including Interpretations), and

(b) considering the modifications that are appropriate on the basis of users' needs and cost-benefit considerations.

The following table identifies the primary sources in full HKFRSs from which the principles in each section of the *HKFRS for Private Entities* were derived.

	Section in the *HKFRS for Private Entities*	**Sources**
	Preface to HKFRS for Private Entities	*Preface to HKFRSs*
1	*Private Entities*	—
2	*Concepts and Pervasive Principles*	*Framework*, HKAS 1 *Presentation of Financial Statements* as revised in 2007
3	*Financial Statement Presentation*	HKAS 1
4	*Statement of Financial Position*	HKAS 1
5	*Statement of Comprehensive Income and Income Statement*	HKAS 1
6	*Statement of Changes in Equity and Statement of Comprehensive Income and Retained Earnings*	HKAS 1
7	*Statement of Cash Flows*	HKAS 7 *Statement of Cash Flows*
8	*Notes to the Financial Statements*	HKAS 1
9	*Consolidated and Separate Financial Statements*	HKAS 27 *Consolidated and Separate Financial Statements* as amended in 2008
10	*Accounting Policies, Estimates and Errors*	HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
11 and 12	*Basic Financial Instruments and Other Financial Instruments Issues*	HKAS 32 *Financial Instruments: Presentation,* HKAS 39 *Financial Instruments: Recognition and Measurement*, HKFRS 7 *Financial Instruments: Disclosures*
13	*Inventories*	HKAS 2 *Inventories*
14	*Investments in Associates*	HKAS 28 *Investments in Associates*
15	*Investments in Joint Ventures*	HKAS 31 *Interests in Joint Ventures*
16	*Investment Property*	HKAS 40 *Investment Property*
17	*Property, Plant and Equipment*	HKAS 16 *Property, Plant and Equipment*
18	*Intangible Assets other than Goodwill*	HKAS 38 *Intangible Assets*

19	*Business Combinations and Goodwill*	HKFRS 3 *Business Combinations* as revised in 2008
20	*Leases*	HKAS 17 *Leases*
21	*Provisions and Contingencies*	HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
22	*Liabilities and Equity*	HKAS 1, HKAS 32
23	*Revenue*	HKAS 11 *Construction Contracts*, HKAS *18 Revenue*
24	*Government Grants*	HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
25	*Borrowing Costs*	HKAS 23 *Borrowing Costs*
26	*Share-based Payment*	HKFRS 2 *Share-based Payment*
27	*Impairment of Assets*	HKAS 2, HKAS 36 *Impairment of Assets*
28	*Employee Benefits*	HKAS 19 *Employee Benefits*
29	*Income Tax*	HKAS 12 *Income Taxes*
30	*Foreign Currency Translation*	HKAS 21 *The Effects of Changes in Foreign Exchange Rates*
31	*Hyperinflation*	HKAS 29 *Financial Reporting in Hyperinflationary Economies*
32	*Events after the End of the Reporting Period*	HKAS 10 *Events after the Reporting Period*
33	*Related Party Disclosures*	HKAS 24 *Related Party Disclosures*
34	*Specialised Activities*	HKAS 41 *Agriculture*, HKFRS 6 *Exploration for and Evaluation of Mineral Resources*
35	*Transition to the HKFRS for Private Entities*	HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

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Basis for Conclusions on
Hong Kong Financial Reporting Standards

Hong Kong Financial Reporting Standard for Private Entities

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香港會計師公會

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Basis for Conclusions
Hong Kong Financial Reporting Standard for Private Entities

Hong Kong Financial Reporting Standard for Private Entities (HKFRS for Private Entities) is based on International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). In approving HKFRS for Private Entities, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the Basis for Conclusions of International Accounting Standards Board (IASB) on IFRS for SMEs. Accordingly, there are no differences between HKFRS for Private Entities and IFRS for SMEs. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS for SMEs referred to below generally correspond with those in HKFRS for Private Entities.

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DISSENTING OPINIONS

Basis for Conclusions on *International Financial Reporting Standard for Small and Medium-sized Entities*

This Basis for Conclusions accompanies, but is not part of, the Standard.

Introduction

BC1A This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) when developing the *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).* Individual IASB members gave greater weight to some factors than to others.

BC1B Paragraphs BC1C–BC165 summarise the IASB's considerations in developing the *IFRS for SMEs* issued in July 2009. In May 2015 the IASB issued *2015 Amendments to the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).* The IASB's considerations in developing these amendments are discussed in paragraphs BC166–BC272.

Basis for Conclusions on 2009 Standard

Background

BC1C In its transition report of December 2000 to the newly formed IASB, the outgoing Board of the International Accounting Standards Committee said 'A demand exists for a special version of International Accounting Standards for Small Enterprises'.BC2 Shortly after its inception in 2001, the IASB began a project to develop accounting standards suitable for small and medium-sized entities (SMEs). The Board set up a working group of experts to provide advice on the issues and alternatives and potential solutions.

BC3 In their 2002 annual report, the Trustees of the IASC Foundation, under which the IASB operates, wrote 'The Trustees also support efforts by the IASB to examine issues particular to emerging economies and to small and medium-sized entities.' In July 2005 the Trustees formalised their support by restating the objectives of the Foundation and the IASB as set out in the Foundation's Constitution. They added an objective that, in developing IFRSs, the IASB should take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies. Similarly, the Standards Advisory Council has consistently encouraged the IASB to pursue the project.

BC4 At public meetings during the second half of 2003 and early 2004, the Board developed some preliminary and tentative views about the basic approach that it would follow in developing accounting standards for SMEs. It tested that approach by applying it to several IFRSs.

Discussion paper (June 2004)

BC5 In June 2004 the Board published a discussion paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* setting out and inviting comments on the Board's approach. This was the first discussion paper that the IASB published. The Board received 120 responses.

BC6 The major issues set out in the discussion paper were:

(a) Should the IASB develop special financial reporting standards for SMEs?

(b) What should be the objectives of a set of financial reporting standards for SMEs?

(c) For which entities would IASB standards for SMEs be intended?

(d) If IASB standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?

(e) May an entity using IASB standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB standard for SMEs?

(f) How should the Board approach the development of IASB standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?

(g) If IASB standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?

(h) In what format should IASB standards for SMEs be published?

BC7 At its meetings later in 2004, the Board considered the issues raised by respondents to the discussion paper. In December 2004 and January 2005, the Board made some tentative decisions on the appropriate way forward for the project. The responses to the discussion paper showed a clear demand for an *International Financial Reporting Standard for SMEs* (*IFRS for SMEs*) and a preference, in many countries, to adopt the *IFRS for SMEs* rather than locally or regionally developed standards. The Board therefore decided to publish an exposure draft of an *IFRS for SMEs* as the next step.

Recognition and measurement questionnaire (April 2005) and public round tables (October 2005)

BC8 Most respondents to the discussion paper said that simplifications of the principles for recognising and measuring assets, liabilities, income and expenses were needed, but few specifics were proposed. And when some specifics were proposed, the commentators generally did not indicate the particular transactions or other events or conditions that create the recognition or measurement problem for SMEs under IFRSs or how that problem might be solved.

BC9 The IASB concluded that it needed further information to assess possible recognition and measurement simplifications. Consequently the Board decided to hold public round-table meetings with preparers and users of the financial statements of SMEs to discuss possible modifications of the recognition and measurement principles in IFRSs for use in an *IFRS for SMEs*. The Board instructed the staff to develop and publish a questionnaire as a tool to identify issues that should be discussed at those round-table meetings.

BC10 The questionnaire, published April 2005, asked two questions:

1 What are the areas for possible simplification of recognition and measurement principles for SMEs?

2 From your experience, please indicate which topics addressed in IFRSs might be omitted from SME standards because they are unlikely to occur in an SME context. If

they occur, the standards would require the SME to determine its appropriate accounting policy by looking to the applicable IFRSs.

BC11 The Board received 101 responses to the questionnaire. Those responses were discussed with the Standards Advisory Council (June 2005), with the SME Working Group (June 2005), World Standard-Setters (September 2005) and at the public round tables held by the Board in October 2005. A total of 43 groups participated in the round-table discussions with the Board over a two-day period.

Board deliberations leading to the exposure draft

BC12 The IASB's working group met in June 2005 and made a comprehensive set of recommendations to the Board regarding the recognition, measurement, presentation and disclosure requirements that should be included in an exposure draft of an *IFRS for SMEs*. Later in 2005, the Board considered those recommendations and the views expressed in the responses to the discussion paper and the questionnaire, and at the round tables. During those deliberations, the Board made tentative decisions about the requirements to be included in the exposure draft.

BC13 On the basis of those tentative decisions, at the Board meeting in January 2006 the staff presented a preliminary draft of the exposure draft. The working group met in late January 2006 to review that draft and prepared a report of its recommendations for the Board's consideration. The Board's discussion of the draft began in February 2006 and continued throughout the remainder of 2006. Revised drafts of the exposure draft were prepared for each Board meeting from May onwards. From July 2003 until the exposure draft was published in February 2007, the issues were deliberated by the Board at 31 public Board meetings.

BC14 To keep constituents informed and help them begin planning their responses, a complete staff draft of the exposure draft was posted on the IASB's website in August 2006. A revised staff draft was posted on the IASB's website in November 2006.

Exposure draft (February 2007)

BC15 In February 2007 the IASB published for public comment an exposure draft of a proposed *IFRS for SMEs*. The aim of the proposed standard was to provide a simplified, self-contained set of accounting principles that are appropriate for smaller, non-listed entities and are based on full IFRSs, which are developed to meet the needs of entities whose securities trade in public capital markets.

BC16 The proposed standard was based on full IFRSs with modifications to reflect the needs of users of SMEs' financial statements and cost-benefit considerations. The exposure draft proposed five types of simplifications of full IFRSs:

(a) some topics in IFRSs were not included because they are not relevant to typical SMEs. However, for some of those omitted topics, the exposure draft proposed that if SMEs encountered circumstances or a transaction that is addressed in full IFRSs but not in the *IFRS for SMEs*, then they would be required to follow the relevant full IFRS.

(b) where an IFRS allows an accounting policy choice, the exposure draft included only the simpler option but proposed that SMEs should be permitted to choose the more complex option by reverting to the relevant full IFRS.

(c) simplification of many of the principles for recognising and measuring assets, liabilities, income, and expenses that are in full IFRSs.

(d) substantially fewer disclosures.

(e) simplified redrafting.

Primarily because of (a) and (b) above, the proposed *IFRS for SMEs* would not be a stand-alone document.

BC17 Along with the exposure draft, the IASB published and invited comment on proposed implementation guidance consisting of a complete set of illustrative financial statements and a disclosure checklist. The exposure draft was accompanied by a basis for conclusions that explained the Board's reasoning in reaching the conclusions in the exposure draft.

BC18 The exposure draft was translated into five languages (a first for the IASB), and the translations were posted on the IASB's website. The IASB also published a staff summary of the exposure draft to help constituents get an initial understanding of the proposals, also posted on the IASB's website.

BC19 Comments on the exposure draft were initially due on 30 September 2007, but the Board extended the deadline to 30 November 2007 primarily at the request of field test participants.

Field tests

BC20 With the help of national standard-setters and others, the IASB completed a field test programme that involved 116 small entities from 20 countries. About 35 per cent had ten or fewer full-time employees. A further 35 per cent of the entities in the sample had between 11 and 50 full-time employees. Over half of the entities had bank loans or significant overdrafts. A third had foreign operations.

BC21 The goals of the field testing were:

(a) to assess understandability of the exposure draft by identifying any parts that field testers found hard to understand.

(b) to assess appropriateness of the scope of topics covered by identifying transactions, events or conditions that the field tester encountered but that were not covered in the draft *IFRS for SMEs*, and to find out how the field tester made its accounting policy decision, including whether it looked to full IFRSs as a reference.

(c) to assess the burden of applying the draft *IFRS for SMEs*, for instance, whether information required to apply it was not available or available only with undue cost or effort.

(d) to assess the impact of the proposals by identifying the nature and degree of changes from the field tester's current GAAP or current reporting practices.

(e) to assess accounting policy choices made by the field testers, and why, where the exposure draft would allow choices.

(f) to assess any special problems in applying the draft *IFRS for SMEs* that arose for field testers that are so-called 'micro entities' (those with fewer than ten employees) and for field testers in developing economies.

(g) to assess the adequacy of implementation guidance by identifying where additional guidance would be helpful to the field tester.

BC22 To help the field testers and others in applying the exposure draft, the IASB published a compliance checklist for the exposure draft that was developed by one of the international accounting firms.

BC23 The field test questionnaire was posted on the IASB's website in June 2007 in English, French and Spanish. Field test entities were asked:

(a) to provide background information about their business and reporting requirements.

(b) to submit their most recent annual financial statements under their existing accounting framework.

(c) to restate those financial statements in accordance with the exposure draft for the same financial year (without prior year information).

(d) to respond to a series of questions designed to identify specific problems encountered in applying the exposure draft.

BC24 A report of the field tests was provided to Board members and posted on the IASB's website. The main factor influencing the type of problems identified by field testers was the nature and extent of differences between the *IFRS for SMEs* and an entity's existing accounting framework.

BC25 About half of the field test entities identified no, or only one or two, issues or problems. The three main issues identified by field testers were the following:

(a) **Annual remeasurements**. Many field testers highlighted the need to perform annual remeasurements of fair values for financial assets and liabilities and residual values for property, plant and equipment as problematic because market prices or active markets were often not available.

(b) **Disclosures**. A significant number of field test entities noted problems due to the nature, volume and complexity of disclosures. Many felt that some of the disclosures required them to provide sensitive information, for example key management personnel compensation when there are only one or two key management personnel.

(c) **Reference to full IFRSs**. Around 20 per cent of the field testers chose to refer back to full IFRSs to apply an option available by cross-reference. Most of those entities already followed full IFRSs or a national GAAP similar to full IFRSs. A few field testers said that they would have wanted to use one of the options but did not do so because of the need to refer back to full IFRSs. Only a small number of entities specifically noted that they needed to refer back to full IFRSs to understand or clarify requirements in the exposure draft.

Responses to the exposure draft

BC26 The Board received 162 letters of comment on the exposure draft. All letters were made available to Board members and posted on the IASB's website. Paragraphs BC36–BC158 discuss the Board's reasoning on the chief technical issues in the project. Here is a brief summary of the main issues raised in the letters of comment on the exposure draft:

(a) **Stand-alone**. The single most pervasive comment was to make the *IFRS for SMEs* a fully stand-alone document, or nearly so. Over 60 per cent of the respondents would eliminate all cross-references to full IFRSs. Virtually all of the remaining respondents either (i) would keep the number of cross-references to an absolute minimum or (ii) were indifferent between having minimal cross-references and removing all of them. The exposure draft had included 23 cross-references to full IFRSs.

(b) **Accounting policy options**. Whether the *IFRS for SMEs* should allow SMEs to use all of the accounting policy options that are available in full IFRSs was discussed by many commentators. This issue is interrelated with making the *IFRS for SMEs* a stand-alone document without cross-references to full IFRSs.

(c) **Anticipating changes to IFRSs**. Many respondents were of the view that the *IFRS for SMEs* should be based on existing IFRSs and should not anticipate changes to IFRSs that the Board is considering in current agenda projects.

(d) **Disclosures**. Many comment letters encouraged the Board to make further simplifications to disclosure requirements, but many of those letters did not identify specific disclosures to be eliminated or why.

(e) **Scope**. Many comment letters discussed the suitability of the exposure draft for micro-sized entities (those with fewer than ten or so employees), small listed entities, and entities that act in a fiduciary capacity.

(f) **Fair value measurements**. Many respondents proposed that fair value measurements in the *IFRS for SMEs* should be restricted to (a) circumstances in which a market price is quoted or readily determinable without undue cost or effort and (b) all derivatives. Some respondents also thought it was necessary that the measured item should be readily realisable or that there should be an intention to dispose or transfer.

(g) **Implementation guidance**. Many respondents cited the need for implementation guidance and encouraged the Board to consider how such guidance could be provided.

(h) **Comments on specific sections of the exposure draft**. In addition to general issues, most comment letters raised issues related to specific sections in the exposure draft. While respondents offered suggestions for each of the 38 sections of the exposure draft, staff noted that the topics that attracted the most comments (generally in favour of further simplifications) included:

(i) consolidation.

(ii) amortisation of goodwill and other indefinite life intangibles.

(iii) financial instruments.

(iv) requirements for statements of cash flows and changes in equity.

(v) measurements for impairments.

(vi) measurements for finance leases.

(vii) share-based payment.

(viii) employee benefits.

(ix) income taxes.

Board redeliberations of the proposals in the exposure draft

BC27 The Board began its redeliberations of the proposals in the exposure draft in March 2008. Those redeliberations continued until April 2009—a total of 13 public Board meetings—bringing to 44 the total number of public meetings at which the Board deliberated the *IFRS for SMEs*.

BC28 At the Board's meeting in March 2008, staff presented an overview of the main issues (other than disclosure issues) raised in the comment letters on the exposure draft (see paragraph BC26). At the Board's next meeting in April 2008, staff presented an overview of the main issues that were identified as a result of the programme for field testing the exposure draft (see paragraph BC25). Both of those meetings were educational in nature, and the staff did not raise any issues for decision.

BC29 The IASB's working group met on 10 and 11 April 2008. The recommendations of working group members on each issue (other than disclosure) that was discussed at that meeting were presented to the Board at the Board's meeting in May 2008. Recommendations of working group members relating to disclosure were presented to the Board in an agenda paper at the Board's meeting in July 2008. The reports of the working group's recommendations were posted on the IASB's website.

BC30 In May 2008, the Board began to redeliberate the proposals in the exposure draft by addressing issues relating to scope, recognition, measurement and presentation that were raised in the letters of comment on the exposure draft, in the reports prepared by field test entities and in the recommendations of the working group. Those redeliberations continued until February 2009. A list of the main changes made as a result of those redeliberations is presented in paragraph BC34.

BC31 In March 2009 the Board considered the changes made during its redeliberations of the exposure draft in the light of the guidelines for re-exposure in the *Due Process Handbook for the IASB*. The Board concluded that the changes made did not warrant re-exposure.

Additional input to the Board

BC32 The project was discussed with the Standards Advisory Council at seven of its meetings. The issues in the project were also discussed at five of the annual meetings of the World Accounting Standard-Setters hosted by the IASB from 2003 to 2008. The working group met four times to discuss the issues and provide advice to the Board. A joint working party of the European Financial Reporting Advisory Group (EFRAG) and the European Federation of Accountants (FEE) was particularly helpful in providing guidance to the staff.

Special outreach

BC33 The Board recognised that, typically, SMEs and their auditors and bankers have not participated in the IASB's due process. With the objectives of encouraging such parties to

become familiar with the IASB and to consider and respond to the exposure draft, the staff undertook a comprehensive outreach programme on this project. That programme entailed presentations at 104 conferences and round tables in 40 countries, including 55 presentations after the exposure draft was published. The IASB also explained the exposure draft and responded to questions in two public webcasts for which nearly 1,000 participants registered. In April 2007 a staff overview of the exposure draft, in question-and-answer format, was posted on the IASB's website. The purpose of the overview was to provide an introduction to the proposals in non-technical language.

Final *IFRS for SMEs*: main changes from the exposure draft

BC34 The main changes from the recognition, measurement and presentation principles proposed in the exposure draft that resulted from the Board's redeliberations were:

(a) making the final IFRS a stand-alone document (eliminating all but one of the 23 cross-references to full IFRSs that had been proposed in the exposure draft, with the one remaining cross-reference providing an option, but not a requirement, to follow IAS 39 *Financial Instruments*: *Recognition and Measurement* instead of the two financial instruments sections of the *IFRS for SMEs*).

(b) eliminating most of the complex options and adding guidance on the remaining ones (thereby removing the cross-references to full IFRSs proposed in the exposure draft).

(c) omitting topics that typical SMEs are not likely to encounter (thereby removing the cross-references to full IFRSs proposed in the exposure draft).

(d) not anticipating possible future changes to IFRSs.

(e) eliminating reference to the pronouncements of other standard-setting bodies as a source of guidance when the *IFRS for SMEs* does not address an accounting issue directly.

(f) conforming to the presentation requirements of IAS 1 *Presentation of Financial Statements*, except for its requirement to present a statement of financial position at the beginning of the earliest comparative period.

(g) allowing different accounting policies to be used to account for different types of investments in separate financial statements, rather than one policy for all types of investment.

(h) restructuring of Section 11 *Financial Assets and Financial Liabilities* of the exposure draft into two sections (Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*) and clarifying that amortised cost is applied to nearly all the basic financial instruments held or issued by SMEs.

(i) amending the requirements for assessing impairment of an equity instrument carried at cost when fair value cannot be measured reliably.

(j) eliminating proportionate consolidation as an option for investments in jointly controlled entities.

(k) removing the distinction between distributions from pre-acquisition and post-acquisition profits for investments accounted for by the cost method and, instead, recognising all dividends received in profit or loss.

(l) eliminating the requirement, when applying the equity method, of a maximum three-month difference between the reporting date of the associate or jointly controlled entity and that of the investor.

(m) requiring an entity to choose its accounting policy for investment property on the basis of circumstances, rather than as a free choice option. Investment property whose fair value can be measured reliably without undue cost or effort will be measured at fair value through profit or loss. All other investment property will be accounted for as property, plant and equipment using a cost-depreciation-impairment model.

(n) not requiring an annual review of residual value, useful life and depreciation method of property, plant and equipment and intangible assets.

(o) not permitting a revaluation option for property, plant and equipment.

(p) not permitting a revaluation option for intangibles.

(q) amortising all indefinite life intangibles, including goodwill.

(r) recognising as expenses all research and development costs.

(s) incorporating 'present value of minimum lease payments' into the measurement of a finance lease.

(t) allowing other than the straight-line method by lessees for operating leases when the minimum lease payments are structured to compensate the lessor for expected general inflation.

(u) incorporating into the *IFRS for SMEs* the February 2008 'puttables' amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1.

(v) requiring all government grants to be accounted for using a single, simplified model: recognition in income when the performance conditions are met (or earlier if there are no performance conditions) and measurement at the fair value of the asset received or receivable.

(w) recognising as expenses all borrowing costs.

(x) adding further simplifications for share-based payments, including directors' valuations, rather than the intrinsic value method.

(y) allowing subsidiaries to measure employee benefit and share-based payment expense on the basis of a reasonable allocation of the group charge.

(z) adding value-in-use measurement for asset impairments.

(aa) introducing the notion of cash-generating unit for testing asset impairments.

(bb) simplifying the guidance for calculating impairment of goodwill.

(cc) simplifying the measurement of a defined benefit pension obligation if a 'projected unit credit' measurement is not available and would require undue cost or effort.

(dd) permitting recognition of actuarial gains and losses in other comprehensive income as an alternative to recognition in profit or loss (while retaining the proposal in the exposure draft to prohibit deferral of actuarial gains and losses).

(ee) on disposal of a foreign operation, not 'recycling' through profit or loss any cumulative exchange differences that were recognised previously in other comprehensive income.

(ff) eliminating the held-for-sale classification and related special measurement requirements.

(gg) incorporating all the IFRS 1 *First-time Adoption of International Financial Reporting Standards* exemptions into Section 35 *Transition to the* IFRS for SMEs.

(hh) incorporating the conclusions of the following Interpretations, which address transactions and circumstances that SMEs often encounter:

(i) IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*.

(ii) IFRIC 4 *Determining Whether an Arrangement Contains a Lease*.

(iii) IFRIC 8 *Scope of IFRS 2*.

(iv) IFRIC 12 *Service Concession Arrangements*.

(v) IFRIC 13 *Customer Loyalty Programmes*.

(vi) IFRIC 15 *Agreements for the Construction of Real Estate*.

(vii) IFRIC 17 *Distributions of Non-cash Assets to Owners*.

(viii) SIC-12 *Consolidation—Special Purpose Entities*.

This Basis for Conclusions

BC35 This Basis for Conclusions sets out the main issues addressed by the Board, the alternatives considered, and the Board's reasons for accepting some alternatives and rejecting others.

Why global financial reporting standards for SMEs?

BC36 Global financial reporting standards, applied consistently, enhance the comparability of financial information. Accounting differences can obscure the comparisons that investors, lenders and others make. By resulting in the presentation of high quality comparable financial information, high quality global financial reporting standards improve the efficiency of allocation and the pricing of capital. This benefits not only those who provide debt or equity capital but also those entities that seek capital because it reduces their compliance costs and removes uncertainties that affect their cost of capital. Global standards also improve consistency in audit quality and facilitate education and training.

BC37 The benefits of global financial reporting standards are not limited to entities whose securities are traded in public capital markets. In the Board's judgement, SMEs—and those who use their financial statements—can benefit from a common set of accounting standards. SMEs' financial statements that are comparable from one country to the next are needed for the following reasons:

(a) Financial institutions make loans across borders and operate multinationally. In most jurisdictions, over half of all SMEs, including the very small ones, have bank loans. Bankers rely on financial statements in making lending decisions and in establishing terms and interest rates.

(b) Vendors want to evaluate the financial health of buyers in other countries before they sell goods or services on credit.

(c) Credit rating agencies try to develop ratings uniformly across borders. Similarly, banks and other institutions that operate across borders often develop ratings in a manner similar to credit rating agencies. Reported financial information is crucial to the rating process.

(d) Many SMEs have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship.

(e) Venture capital firms provide funding to SMEs across borders.

(f) Many SMEs have outside investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they have interests in other SMEs.

Should the IASB develop standards for SMEs?

BC38 In deciding to develop an *IFRS for SMEs*, the IASB was mindful of the following issues:

(a) Should financial reporting standards for SMEs be developed by others?

(b) Do national standard-setters support the IASB developing an *IFRS for SMEs*?

(c) Is developing an *IFRS for SMEs* consistent with the Board's mission?

(d) Existing IFRSs make some distinctions for SMEs.

Should others do it?

BC39 The Board considered whether financial reporting standards for SMEs would best be developed by others—either globally, country by country, or perhaps at a regional level—while the IASB focused its efforts primarily on standards for entities that participate in public capital markets. However, the Board noted that its mission, as set out in the IASC Foundation's Constitution (see paragraph BC42), is not restricted to standards for entities that participate in public capital markets. Focusing only on those entities is likely to result in standards or practices for other entities (which are over 99 per cent of all entities in virtually all jurisdictions) that may not address the needs of external users of financial statements, are not consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements* or standards, may lack comparability across national boundaries or within a country, and may not allow for an easy transition to full IFRSs for entities that wish to enter the public capital markets. For those reasons, the Board decided to undertake the project.

Do national standard-setters support an IASB initiative?

BC40 National accounting standard-setters throughout the world support the IASB's initiative. In September 2003 the IASB hosted a meeting of the world's national accounting standard-setters. In preparation for that meeting the Board surveyed them about standards for SMEs. With near unanimity, the standard-setters that responded said that the IASB should develop global standards for SMEs.

BC41 The Board discussed the progress on its project on standards for SMEs at subsequent annual meetings of the world's national accounting standard-setters in 2005–2008. Standard-setters continued to support the Board's project.

An *IFRS for SMEs* is consistent with the IASB's mission

BC42 Developing a set of standards for SMEs is consistent with the IASB's mission. The principal objective of the IASB, as set out in the Constitution and in the *Preface to International Financial Reporting Standards*, is 'to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions'. 'Single set' means that all entities in similar circumstances globally should follow the same standards. The circumstances of SMEs can be different from those of larger, publicly accountable entities in several ways, including:

(a) the users of the entity's financial statements and their information needs;

(b) how the financial statements are used by those users;

(c) the depth and breadth of accounting expertise available to the entity; and

(d) SMEs' ability to bear the costs of following the same standards as the larger, publicly accountable entities.

Existing IFRSs include some differences for non-public entities

BC43 IFRSs include several differences for entities whose securities are not publicly traded. For example:

(a) IFRS 8 *Operating Segments* requires disclosure of segment information only by entities whose debt or equity instruments are traded or registered for trading in a public market.

(b) IAS 27 *Consolidated and Separate Financial Statements* exempts some parent entities from preparing consolidated financial statements if (i) the parent itself is a subsidiary of an IFRS parent and (ii) its debt or equity instruments are not traded in a public market. Similar exemptions are in IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

(c) IAS 33 *Earnings per Share* requires presentation of earnings per share data only by entities whose ordinary shares or potential ordinary shares are publicly traded.

Different users' needs and cost-benefit considerations

BC44 The *Framework* (paragraph 12) states:

> The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

In establishing standards for the form and content of general purpose financial statements, the needs of users of financial statements are paramount.

BC45 Users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with full IFRSs than users of financial statements of entities whose securities are registered for trading in public securities markets or that otherwise have public accountability. For example, users of financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of profit or loss and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, profit or loss, and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SMEs can obtain bank financing.

BC46 In the Board's judgement, the nature and degree of the differences between full IFRSs and an *IFRS for SMEs* must be determined on the basis of users' needs and cost-benefit analyses. In practice, the benefits of applying accounting standards differ across reporting entities, depending primarily on the nature, number and information needs of the users of their financial statements. The related costs may not differ significantly. Therefore, consistently with the *Framework*, the Board concluded that the cost-benefit trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

BC47 The Board faced a dilemma in deciding whether to develop an *IFRS for SMEs*. On the one hand, it believed that the same concepts of financial reporting are appropriate for all entities regardless of public accountability—particularly the concepts for recognising and measuring assets, liabilities, income and expenses. This suggested that a single set of accounting standards should be suitable for all entities, although it would not rule out disclosure differences based on users' needs and cost-benefit considerations. On the other hand, the

Board acknowledged that differences in the types and needs of users of SMEs' financial statements, as well as limitations in, and the cost of, the accounting expertise available to SMEs, suggested that a separate standard for SMEs is appropriate. That separate standard could include constraints such as consistent definitions of elements of financial statements and focus on the needs of users of financial statements of SMEs. On balance, the Board concluded that the latter approach (separate standard) was appropriate.

Adoption of an *IFRS for SMEs* does not imply that full IFRSs are not appropriate for SMEs

BC48 The Board believes that the objective of financial statements as set out in the *Framework* is appropriate for SMEs as well as for entities required to apply full IFRSs. The objective of providing information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions is applicable without regard to the size of the reporting entity. Therefore, standards for general purpose financial statements of entities with public accountability would result in financial statements that meet the needs of users of financial statements of all entities, including those without public accountability. The Board is aware of research that shows that over 80 jurisdictions currently require or permit SMEs to use full IFRSs.

The objective of the *IFRS for SMEs*

Why determination of taxable income and determination of distributable income are not specific objectives of the *IFRS for SMEs*

BC49 IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. General purpose financial statements are intended to meet the needs of users that are not in a position to demand reports tailored to their particular information needs. General purpose financial statements provide information about an entity's financial position, performance and cash flows.

BC50 Determining taxable income requires special purpose financial statements—ones designed to comply with the tax laws and regulations in a particular jurisdiction. Similarly, an entity's distributable income is defined by the laws and regulations of the country or other jurisdiction in which it is domiciled.

BC51 Tax authorities are also often important external users of the financial statements of SMEs. Almost invariably, tax authorities have the power to demand whatever information they need to meet their statutory tax assessment and collection obligations. Tax authorities often look to financial statements as the starting point for determining taxable profit, and some have policies to minimise the adjustments to accounting profit or loss for the purpose of determining taxable profit. Nonetheless, global accounting standards for SMEs cannot deal with tax reporting in individual jurisdictions. But profit or loss determined in conformity with the *IFRS for SMEs* can serve as the starting point for determining taxable profit in a given jurisdiction by means of a reconciliation that is easily developed at a national level.

BC52 A similar reconciliation can be developed to adjust profit or loss as measured by the *IFRS for SMEs* to distributable income under national laws or regulations.

Why it is not the purpose of the *IFRS for SMEs* to provide information to owner-managers to help them make management decisions

BC53 Owner-managers use SMEs' financial statements for many purposes. However, it is not the purpose of the *IFRS for SMEs* to provide information to owner-managers to help them make management decisions. Managers can obtain whatever information they need to run their business. (The same is true for full IFRSs.) Nonetheless, general purpose financial statements will often also serve managers' needs by providing insights into the business's financial position, performance and cash flows.

BC54 SMEs often produce financial statements only for the use of owner-managers, or for tax reporting or other non-securities regulatory filing purposes. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

'Public accountability' as the principle for identifying the entities for which the *IFRS for SMEs* is intended and those for which it is not intended

BC55 One of the first issues confronting the Board was to describe the class of entities for which the *IFRS for SMEs* would be intended. The Board recognised that, ultimately, decisions on which entities should use the *IFRS for SMEs* will rest with national regulatory authorities and standard-setters. However, a clear definition of the class of entity for which the *IFRS for SMEs* is intended is essential so that:

(a) the Board can decide on the standard that is appropriate for that class of entity, and

(b) national regulatory authorities, standard-setters, reporting entities and their auditors will be informed of the intended scope of applicability of the *IFRS for SMEs*.

In that way, jurisdictions will understand that there are some types of entities for which the *IFRS for SMEs* is not intended.

BC56 In the Board's judgement, the *IFRS for SMEs* is appropriate for an entity that does not have public accountability. An entity has public accountability (and therefore should use full IFRSs) if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

BC57 While the two criteria for entities with public accountability stated in the preceding paragraph did not change significantly from those proposed in the exposure draft, the Board did make several small changes in response to comments received:

(a) The exposure draft referred to, but did not define, public markets. The *IFRS for SMEs* includes a definition consistent with the definition in IFRS 8.

(b) The exposure draft had proposed that any entity that holds assets in a fiduciary capacity for a broad group of outsiders should not be eligible to use the *IFRS for*

SMEs. Respondents noted that entities often hold assets in a fiduciary capacity for reasons incidental to their primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises and utility companies). The *IFRS for SMEs* clarifies that those circumstances do not result in an entity having public accountability.

Entities whose securities are traded in a public market have public accountability

BC58 Public securities markets, by their nature, bring together entities that seek capital and investors who are not involved in managing the entity and who are considering whether to provide capital, and at what price. Although those public investors often provide longer-term risk capital, they do not have the power to demand the financial information they might find useful for investment decision-making. They must rely on general purpose financial statements. An entity's decision to enter a public capital market makes it publicly accountable—and it must provide the outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources. Governments recognise this public accountability by establishing laws, regulations and regulatory agencies that deal with market regulation and disclosures to investors in public securities markets. The Board concluded that, regardless of size, entities whose securities are traded in a public market should follow full IFRSs.

Financial institutions have public accountability

BC59 Similarly, a primary business of banks, insurance companies, securities brokers/ dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Because such an entity acts in a public fiduciary capacity, it is publicly accountable. In most cases, these institutions are regulated by laws and government agencies.

SMEs that provide an essential public service

BC60 In the discussion paper, the Board's tentative view was that, in addition to the two conditions cited in paragraph BC56, an entity also has public accountability if it is a public utility or similar entity that provides an essential public service.

BC61 Most respondents to the discussion paper, and also the working group, pointed out that in many jurisdictions entities that provide public services can be very small—for example, refuse collection companies, water companies, local power generating or distribution companies, and local cable television companies. Respondents argued that the nature of the users of the financial statements, rather than the nature of the business activity, should determine whether full IFRSs should be required. The Board concurred.

SMEs that are economically significant in their home jurisdiction

BC62 In the discussion paper, the Board's tentative view was that, in addition to the two conditions cited in paragraph BC56, an entity also has public accountability if it is economically significant in its home country on the basis of criteria such as total assets, total income, number of employees, degree of market dominance and nature and extent of external borrowings.

BC63 Most respondents, and the working group, argued that economic significance does not automatically result in public accountability. Public accountability, as that term is used in paragraphs 1.2 and 1.3, refers to accountability to those present and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs. The Board concluded that economic significance may be more relevant to matters of political and societal accountability. Whether such accountability requires general purpose financial statements using full IFRSs is a matter best left to local jurisdictions to decide.

Approval by owners to use the *IFRS for SMEs*

BC64 In the discussion paper, the Board's tentative view was that 100 per cent of the owners of a small or medium-sized entity must agree before the entity could use the *IFRS for SMEs*. The objection of even one owner of an entity to the use of the *IFRS for SMEs* would be sufficient evidence of the need for that entity to prepare its financial statements on the basis of full IFRSs. Most respondents did not agree. In their view, an objection, or even a non-response, by one or a few shareholders does not make an entity publicly accountable. They thought that the two criteria of (a) publicly traded and (b) financial institution appropriately identify entities with public accountability. The Board found those arguments persuasive.

SMEs that are a subsidiary, associate or joint venture of an IFRS investor

BC65 In the discussion paper, the Board's tentative view was that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of the parent, venturer or investor, it should be required to comply with full IFRSs, not the *IFRS for SMEs*, in its separate financial statements. In the Board's view, because the information in accordance with full IFRSs had been produced for other purposes, it would be more costly to prepare a second set of financial statements that comply with the *IFRS for SMEs*. Most respondents to the discussion paper did not agree. Many said that the IFRS data produced for consolidation or equity accounting purposes have a different materiality threshold from that necessary for the investee's own financial statements. Moreover, they said that the circumstances of the entity, rather than the circumstances of its parent or investor, should determine whether it has public accountability. Consequently, they argued, it would be costly and burdensome for the investee to have to apply full IFRSs in its own financial statements. The Board found those arguments persuasive. Therefore, SMEs should assess their eligibility to use the *IFRS for SMEs* on the basis of their own circumstances, even if they also submit financial information in accordance with full IFRSs to a parent, venturer or investor.

BC66 Some respondents to the exposure draft proposed that a subsidiary whose parent uses full IFRSs, or is part of a consolidated group that uses full IFRSs, should be permitted to make the simplified disclosures required by the *IFRS for SMEs* but should be required to follow the accounting recognition and measurement principles in full IFRSs that are used by its parent if they are different from the accounting recognition and measurement principles in the *IFRS for SMEs*. Those holding this view thought that allowing the subsidiary to use the same recognition and measurement principles as its parent or its group would make consolidation easier.

BC67 The Board concluded, however, that the result would be, in effect, optional fallbacks to full IFRSs for a relatively small subset of entities eligible to use the *IFRS for SMEs*. The result would also be a hybrid set of accounting standards that is neither full IFRSs nor the *IFRS for SMEs*. That set of standards would differ for each such small or medium-sized entity depending on the accounting policies chosen by its parent or its group. The *IFRS for SMEs* is a standard appropriate for non-publicly accountable entities, not a 'pick and choose' set of

options. A subsidiary of a full IFRS entity can always choose to follow full IFRSs in its separate statements. The Board concluded that if an entity's financial statements are described as conforming to the *IFRS for SMEs*, it must comply with all of the provisions of that IFRS.

BC68 Because the *IFRS for SMEs* allows accounting policy choices for some recognition and measurement principles, differences from full IFRSs can be minimised by an entity's accounting policy choices. The circumstances in which the *IFRS for SMEs* would mandate a recognition or measurement principle that is different from measurement under full IFRSs are limited. The following are the principal examples:

(a) Non-current assets (or groups of assets and liabilities) held for sale

- *IFRS for SMEs*: Holding assets for sale triggers an assessment for impairment, but otherwise no special 'held-for-sale' classification or special accounting requirements.
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*: Measured at lower of carrying amount and fair value less costs to sell. Depreciation stops when classified as held for sale.

(b) Unvested past service cost of defined benefit pension plans

- *IFRS for SMEs*: Recognised in profit or loss immediately.
- IAS 19 *Employee Benefits*: Recognised as an expense on a straight-line basis over the average period until the benefits become vested.

(c) Exchange differences on a monetary item that forms part of the net investment in a foreign operation, in consolidated financial statements

- *IFRS for SMEs*: Recognise in other comprehensive income and do not reclassify in profit or loss on disposal of the investment.
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*: Reclassify in profit or loss on disposal of the investment.

(d) Borrowing costs

- *IFRS for SMEs*: Must be charged to expense.
- IAS 23 *Borrowing Costs*: Costs directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.

(e) Investment in an associate for which there is a published price quotation

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 28 *Investments in Associates*: Must be measured using the equity method.

(f) Investment in a jointly controlled entity for which there is a published price quotation

- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
- IAS 31 *Interests in Joint Ventures*: Must be measured using the equity method or proportionate consolidation.

(g) Investment property whose fair value can be measured reliably without undue cost or effort

- IFRS for SMEs: Must be measured at fair value through profit or loss.
- IAS 40 Investment Property: Accounting policy choice of fair value through profit or loss or cost-depreciation-impairment model.

(h) Biological assets

- *IFRS for SMEs*: Measure at fair value through profit or loss only if fair value is readily determinable without undue cost or effort.
- IAS 41 *Agriculture*: Presumption that fair value can be reliably measured.

(i) Income tax

- *IFRS for SMEs*: Where a different tax rate applies to distributed income, initially measure current and deferred taxes at the rate applicable to undistributed profits.
- Exposure draft *Income Tax*: In such a case, initially measure current and deferred taxes at the tax rate expected to apply when the profits are distributed.

(j) Share-based payments with cash alternatives in which the terms of the arrangement provide the counterparty with a choice of settlement

- *IFRS for SMEs*: Account for the transaction as a cash-settled share-based payment transaction unless either the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.
- IFRS 2 *Share-based Payment*: Accounting akin to a compound instrument.

Quantified size criteria

BC69 The definition of SMEs does not include quantified size criteria for determining what is a small or medium-sized entity. The Board noted that its standards are used in over 100 countries. The Board concluded that it is not feasible to develop quantified size tests that would be applicable and long-lasting in all of those countries. This is consistent with the Board's general principle-based approach to standard-setting.

BC70 In deciding which entities should be required or permitted to use the *IFRS for SMEs*, jurisdictions may choose to prescribe quantified size criteria. Similarly, a jurisdiction may decide that entities that are economically significant in that country should be required to use full IFRSs rather than the *IFRS for SMEs*.

Suitability of the *IFRS for SMEs* for very small entities—the 'micros'

BC71 Some contend that it is unrealistic to design a single standard that could be used by all entities that do not have public accountability, because the size range of this group of entities is simply too broad—from very large unlisted entities with hundreds or even several thousand employees down to 'micro-sized' entities with fewer than ten employees. The Board did not

agree. The *IFRS for SMEs* is designed for entities, regardless of size, that are required, or elect, to publish general purpose financial statements for external users. External users such as lenders, vendors, customers, rating agencies and employees need specific types of information but are not in a position to demand reports tailored to meet their particular information needs. They must rely on general purpose financial statements. This is as true for 'micros' as it is for larger SMEs. Financial statements prepared using the *IFRS for SMEs* are intended to meet those needs.

BC72 Some who question whether the *IFRS for SMEs* will be suitable for micros argue that many micro entities prepare financial statements solely to submit to income tax authorities for the purpose of determining taxable income. As explained more fully in paragraphs BC50–BC52, determining taxable income (and also determining legally distributable income) requires special purpose financial statements—ones designed to comply with tax and other laws and regulations in a particular jurisdiction.

BC73 Moreover, the Board noted that, in many countries, full IFRSs are required for all or most limited liability companies, including the micros. The Board also noted that many other countries permit the micros to use full IFRSs. As mentioned in paragraph BC48, over 80 jurisdictions have decided that full IFRSs should be required or permitted for all or most entities, including micros. If full IFRSs have been judged suitable for all entities, then the *IFRS for SMEs* will surely not be burdensome. The guidance in the *IFRS for SMEs* is clear and concise. That guidance may cover some transactions or circumstances that micro SMEs do not typically encounter, but the Board did not believe that this imposes a burden on micro SMEs. The topical organisation of the *IFRS for SMEs* will make it easy for micro SMEs to identify those aspects of the standard that are relevant to their circumstances.

BC74 Some favour a very simple and brief set of accounting requirements for micro SMEs—with broad principles of accrual basis accounting (some even suggest a cash basis or modified cash basis), specific recognition and measurement principles for only the most basic transactions, and requiring perhaps only a balance sheet and an income statement with limited note disclosures. The Board acknowledged that this approach might result in relatively low costs to SMEs in preparing financial statements. However, the Board concluded that the resulting statements would not meet the objective of decision-usefulness because they would omit information about the entity's financial position, performance and changes in financial position that is useful to a wide range of users in making economic decisions. Moreover, the Board believed that financial statements prepared using such a simple and brief set of accounting requirements might not serve SMEs by improving their ability to obtain capital. Therefore, the Board concluded that it should not develop this type of *IFRS for SMEs*.

BC75 The IASB does not have the power to require any entity to use its standards. That is the responsibility of legislators and regulators. In some countries, the government has delegated that power to a separately established independent standard-setter or to the professional accountancy body. They will have to decide which entities should be required or permitted to use, or perhaps prohibited from using, the *IFRS for SMEs*. The Board believes that the *IFRS for SMEs* will be suitable for all entities that do not have public accountability, including micros.

The *IFRS for SMEs* is not intended for small publicly traded entities

BC76 Entities, large or small, whose debt or equity instruments are traded in public capital markets have chosen to seek capital from outside investors who are not involved in managing the business and who do not have the power to demand information that they might find useful. Full IFRSs have been designed to serve public capital markets by providing financial information especially intended for investors and creditors in such markets. Some of the principles in full IFRSs for recognising and measuring assets, liabilities, income and expense have been simplified in the *IFRS for SMEs*. Some of the disclosures required by full IFRSs

are not required by the *IFRS for SMEs*. The Board concluded, therefore, that full IFRSs are appropriate for an entity with public accountability.

BC77 A jurisdiction that believes that the *IFRS for SMEs* is appropriate for small publicly traded entities in that jurisdiction could incorporate the requirements of the *IFRS for SMEs* into its national standards for small publicly traded entities. In that case, however, the financial statements would be described as conforming to national GAAP. The *IFRS for SMEs* prohibits them from being described as conforming to the *IFRS for SMEs*.

'Small and medium-sized entities'

BC78 'Small and medium-sized entities' (SMEs) as used by the IASB is defined in Section 1 of the *IFRS for SMEs*. The term is widely recognised and used around the world, although many jurisdictions have developed their own definitions of the term for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantitative criteria based on revenue, assets, employees or other factors. Frequently, the term is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.

BC79 The IASB considered whether to use another term. Even before publishing the exposure draft in February 2007, the Board had used the term 'non-publicly accountable entity' (NPAE) for several months during 2005. During its redeliberations of the proposals in the exposure draft during 2008, the Board also used both NPAE and 'private entities' for several months.

(a) **Non-publicly accountable entities**. Because the Board concluded that full IFRSs are necessary for entities with public accountability, the terms 'publicly accountable entity' and 'non-publicly accountable entity' had some appeal. However, constituents argued that this term is not widely recognised, whereas 'small and medium-sized entities' and the acronym 'SMEs' are universally recognised. Also, some said that 'non-publicly accountable entities' seemed to imply, incorrectly, that the smaller entities were not publicly accountable for anything. Furthermore, the objectives of the IASC Foundation and the IASB as set out in the Foundation's Constitution use the term 'small and medium-sized entities':

> The objectives of the IASC Foundation are:
>
> (a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
>
> (b) to promote the use and rigorous application of those standards;
>
> (c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and
>
> (d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

(b) **Private entities**. The term 'private entities' is commonly used in some jurisdictions—most particularly in North America—to refer to the kinds of entities that meet the IASB's definition of SMEs (entities without public accountability). In other jurisdictions, however—most particularly those in which government ownership of equity interests in business entities is common—the term 'private entities' is used much more

restrictively to refer only to those entities in which there is no government ownership. In such jurisdictions, the term 'private entities' would be likely to be misunderstood.

For these reasons, the Board decided to use 'small and medium-sized entities'.

The users of SMEs' financial statements prepared using the *IFRS for SMEs*

BC80 The *IFRS for SMEs* is intended for non-publicly accountable entities that publish general purpose financial statements for external users. The main groups of external users include:

(a) banks that make loans to SMEs.

(b) vendors that sell to SMEs and use SMEs' financial statements to make credit and pricing decisions.

(c) credit rating agencies and others that use SMEs' financial statements to rate SMEs.

(d) customers of SMEs that use SMEs' financial statements to decide whether to do business.

(e) SMEs' shareholders that are not also managers of their SMEs.

The extent to which the *IFRS for SMEs* should be a stand-alone document

BC81 In developing the exposure draft of the proposed *IFRS for SMEs*, the Board intended it to be a stand-alone document for many typical small entities. However, it was not proposed to be fully stand-alone. The exposure draft proposed that there should be two types of occasions when the *IFRS for SMEs* would require entities to look to full IFRSs:

(a) The exposure draft proposed that when IFRSs provide an accounting policy option, SMEs should have the same option. The simpler option would be included in the *IFRS for SMEs* while the other option or options would be permitted by cross-reference to IFRSs.

(b) The exposure draft proposed that the *IFRS for SMEs* should omit some accounting topics that are addressed in full IFRSs, because the Board believed that typical SMEs are not likely to encounter such transactions or circumstances. However, the exposure draft proposed cross-references requiring SMEs that encounter such a transaction or circumstances to look to a particular IFRS or to a part of one.

BC82 Over 60 per cent of the comment letters that addressed the 'stand-alone' issue would eliminate all cross-references to full IFRSs. Another 35 per cent either (a) would keep the number of cross-references to an absolute minimum or (b) were indifferent between having minimal cross-references and removing all cross-references. Also, the working group members recommended that the *IFRS for SMEs* should be a completely stand-alone document. The principal reasons put forward by those recommending a stand-alone IFRS were:

(a) A stand-alone document would be more understandable and easier to use. It would also be perceived as a more user-friendly document and hence improve acceptance by jurisdictions considering adoption and by entities within the scope. Cross-references require SMEs to be familiar with both the *IFRS for SMEs* and full IFRSs—

a requirement some viewed as even more burdensome than for an entity following full IFRSs.

(b) The exposure draft had proposed that if an entity is required or permitted to follow an IFRS by cross-reference, the entity must apply that IFRS (or part of that IFRS) in full. The twin criteria of user needs and cost-benefits on which the Board based its decisions in the *IFRS for SMEs* were not applied to the cross-referenced material. However, if such cross-referenced topics were incorporated within the *IFRS for SMEs*, it would be possible to make appropriate simplifications of recognition and measurement principles and/or reduce disclosures based on the user needs and cost-benefit criteria adopted by the Board.

(c) Cross-references cause 'version control' issues. For example, if a cross-referenced IAS or IFRS or Interpretation is amended or replaced, should that result in an 'automatic' change to the cross-reference? Or does the cross-reference to the earlier version of the IAS or IFRS or Interpretation remain? If there is an automatic change, then this will cause more frequent updates to the *IFRS for SMEs* than the periodic review planned by the Board. Also it would require SMEs applying cross-references to be aware of all changes to full IFRSs. If the cross-reference to the earlier version of the pronouncement remains, there may be confusion about which version of the Standard should be applied, especially because some cross-referenced paragraphs themselves, either directly or indirectly, refer to paragraphs of other full IFRSs (see (d) below). Also, the accounting chosen or required by cross-reference will not be comparable with that applied by full IFRS entities. Additionally, if changes to full IFRSs are *de facto* amendments to the *IFRS for SMEs*, SMEs would need to participate in the due process that led to the changes in each IFRS—a burden SMEs generally told the Board they cannot handle (in responses to both the June 2004 discussion paper and the exposure draft).

(d) There is a question of where the cross-references end. Some cross-referenced paragraphs, either directly or indirectly, refer to other paragraphs within full IFRSs. This is problematic because updates are made to full IFRSs, so SMEs would need to continuously monitor full IFRSs in case any changes might affect them via the cross-reference.

BC83 After considering the points raised by respondents to the exposure draft, the Board changed its view. The *IFRS for SMEs* does not have any mandatory requirement to look to full IFRSs.

Accounting policy options

BC84 The accounting policy options mentioned in paragraph BC81(a) for which the exposure draft had included cross-references to full IFRSs have been dealt with in the *IFRS for SMEs* as follows:

(a) **Associates**. The options proposed in the exposure draft (cost method, equity method and fair value through profit or loss) are all allowed and incorporated into the *IFRS for SMEs*.

(b) **Borrowing costs**. The capitalisation model is not an option. Therefore, no cross-reference to full IFRSs. Guidance on applying the expense method had been proposed in the exposure draft and has been retained.

(c) **Development costs**. Capitalisation of development costs is not an option. Therefore, no cross-reference to full IFRSs.

(d) **Intangible assets**. The revaluation model is not an option. Therefore, no cross-reference to full IFRSs. Guidance on applying the cost-depreciation-impairment model had been proposed in the exposure draft and has been retained.

(e) **Investment property**. Measurement is driven by circumstances rather than an accounting policy choice between the cost and fair value models. If an entity can measure the fair value of an item of investment property reliably without undue cost or effort, it must use the fair value model. Otherwise, it must use the cost model. Guidance on applying the fair value model has been incorporated into the *IFRS for SMEs*.

(f) **Jointly controlled entities**. The options in the exposure draft are all allowed (with the exception of proportionate consolidation) and incorporated into the *IFRS for SMEs*.

(g) **Presenting operating cash flows**. The option to use either the direct or the indirect method has been retained. Guidance on applying direct method has been incorporated into the *IFRS for SMEs*. Guidance on applying the indirect method had been proposed in the exposure draft and has been retained.

(h) **Property, plant and equipment**. The revaluation model is not an option. Therefore, no cross-reference to full IFRSs. Guidance on applying the cost-depreciation-impairment model had been proposed in the exposure draft and has been retained.

(i) **Government grants**. The proposed option to apply IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to some government grants has been removed.

BC85 The *IFRS for SMEs* does include one option for an entity to choose to follow a full IFRS, and that is the option to use IAS 39 *Financial Instruments: Recognition and Measurement* instead of Section 11 and Section 12. Otherwise, the final *IFRS for SMEs* is completely stand-alone — an entity applying it is not required to look to full IFRSs in addition to the *IFRS for SMEs*.

BC86 The exposure draft also proposed that if the standard does not address a transaction or other event or condition or provide a cross-reference back to another IFRS, an entity should select an accounting policy that results in relevant and reliable information. In making that judgement, an entity should consider, first, the requirements and guidance in the *IFRS for SMEs* dealing with similar and related issues and, second, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles* of the draft standard. If that does not provide guidance, the entity may look to the requirements and guidance in IFRSs, including Interpretations of IFRSs, dealing with similar and related issues. This guidance remains in the *IFRS for SMEs*.

Omitted topics

BC87 In addition to the complex options, the second type of mandatory cross-reference to full IFRSs proposed in the exposure draft related to topics addressed in full IFRSs but omitted from the *IFRS for SMEs* because they were not expected to be relevant for the majority of SMEs. To make the final *IFRS for SMEs* a stand-alone document, the Board decided to incorporate into the final *IFRS for SMEs* the following topics for which the exposure draft had proposed a cross-reference to full IFRSs:

(a) **Equity-settled share-based payment**. Addressed in Section 26 *Share-based Payment*.

(b) **Share-based payment transactions with cash alternatives**. Addressed in Section 26.

(c) **Fair value measurement of biological assets**. Addressed in Section 34 *Specialised Activities*.

(d) **Hyperinflation**. Addressed in Section 31 *Hyperinflation*.

(e) **Lessor accounting for finance leases**. Addressed in Section 20 *Leases*.

(f) **The direct method of presenting operating cash flows**. Addressed in Section 7 *Statement of Cash Flows*.

BC88 Furthermore, the Board decided that the *IFRS for SMEs* should not address the following topics for which the exposure draft had proposed a cross-reference to full IFRSs:

(a) Earnings per share.

(b) Interim financial reporting.

(c) Segment reporting.

(d) Special accounting for assets held for sale.

Whether all accounting policy options in full IFRSs should be allowed in the *IFRS for SMEs*

BC89 Full IFRSs include some accounting policy options (choices). Generally, for a given transaction, event or condition, one of the options is simpler to implement than the other(s). Some believe that the *IFRS for SMEs* should eliminate all accounting policy options and, therefore, require all SMEs to follow a single accounting policy for a given transaction, event or condition. Those who hold this view argue that the benefits would be simplification of the *IFRS for SMEs* and greater comparability of the resulting financial information among SMEs using the *IFRS for SMEs*. Others argue that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities applying full IFRSs.

BC90 In developing the exposure draft, the Board considered both points of view and, on balance, had concluded that all options in full IFRSs should be available to SMEs. At the same time, the Board recognised that most SMEs are likely to prefer the simpler option in full IFRSs. Therefore, the exposure draft proposed that when full IFRSs allow accounting policy options, the *IFRS for SMEs* should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRS.

BC91 Respondents to the exposure draft were divided on whether the more complex options should be available to SMEs. Their comments reflected both of the points of view described in paragraph BC89. Many respondents argued that allowing the complex accounting policy options is not consistent with the Board's objective of a simplified standard for smaller entities and would hinder comparability. For example, while supporting the Board's tentative decision to make the *IFRS for SMEs* a stand-alone standard, the European Financial Reporting Advisory Group (EFRAG) and the European Federation of Accountants (FEE) and some national professional accountancy bodies and standard-setters wrote to the Board disagreeing with the tentative decision during redeliberations to retain all or most of the complex options. This issue was discussed at the Standards Advisory Council (SAC) meeting in November 2008, and all SAC members supported allowing in the *IFRS for SMEs* only the simpler options. They noted that most SMEs will choose to follow the simpler options as they

will generally be less costly, require less expertise and achieve greater comparability with their peers. They also pointed out that if a private entity feels strongly about using one or more of the complex options, it could elect to follow full IFRSs rather than the *IFRS for SMEs*.

BC92 Many who supported not permitting the complex accounting policy options felt that this would benefit users of financial statements who need to make comparisons between smaller entities. Users of SMEs' financial statements are often less sophisticated than users of financial statements of publicly accountable entities and so would benefit from less variation in accounting requirements between entities. Moreover, reducing options does not hinder comparability with entities using full IFRSs since, in many cases under full IFRSs, entities may apply different accounting policies from each other for the same transactions.

BC93 Virtually all who favoured keeping at least some of the options also favoured making the *IFRS for SMEs* a stand-alone document, which would mean that the options would be addressed directly in the *IFRS for SMEs* rather than by cross-reference to full IFRSs. They acknowledged that this could cause a significant increase in the size of the *IFRS for SMEs*.

BC94 After considering the alternatives, the Board concluded that some of the options should not be available to SMEs while others should be available to SMEs. Furthermore, to make the *IFRS for SMEs* a stand-alone document, the Board concluded that those options available to SMEs should be addressed directly, appropriately simplified from full IFRSs. Paragraph BC84 explains the Board's decisions on individual options.

Why the *Framework* and principles and mandatory guidance in existing IFRSs are the appropriate starting point for developing the *IFRS for SMEs*

BC95 The *IFRS for SMEs* was developed by:

(a) extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.

BC96 The Board judged that this approach is appropriate because the needs of users of financial statements of SMEs are similar in many ways to the needs of users of financial statements of publicly accountable entities. Therefore, full IFRSs are the logical starting point for developing an *IFRS for SMEs*.

BC97 The Board rejected the alternative 'fresh start' approach because that approach could have resulted in different objectives of financial reports, different qualitative characteristics of financial information, different definitions of the elements of financial statements, and different concepts of recognition and measurement. The Board concluded that a 'fresh start' approach would be costly and time-consuming and ultimately futile. This is because, in the Board's view, there is sufficient convergence of users' needs relative to the general purpose financial statements of entities with and without public accountability.

Recognition and measurement simplifications

BC98 Paragraphs BC99–BC136 explain the significant simplifications to the recognition and measurement principles in full IFRSs that are reflected in the *IFRS for SMEs*, and the reasons for them. The Board also deliberated other recognition and measurement simplifications but decided not to adopt them (see paragraphs BC137–BC150).

Financial instruments

BC99 Many commentators said that the requirements of IAS 39 are burdensome for SMEs. They cited as especially burdensome for SMEs the complexities of classifying financial instruments into four categories, the 'pass-through' and 'continuing involvement' tests for derecognition, and the detailed calculations required to qualify for hedge accounting. The Board agreed that simplifications of IAS 39 are appropriate for SMEs.

BC100 Much of the complexity in IAS 39 results from permitting entities to choose from a range of classification alternatives and measurement attributes for financial instruments. Those choices reduce comparability and impose measurement complexity. The *IFRS for SMEs* enhances comparability and reduces complexity by limiting the classification categories, specifying a measurement attribute and limiting the use of other optional measurement attributes.

BC101 Principal among the simplifications proposed in the *IFRS for SMEs* are the following:

(a) **Classification of financial instruments**. Financial instruments that meet specified criteria are measured at cost or amortised cost, and all others are measured at fair value through profit or loss. The available-for-sale and held-to-maturity classifications in IAS 39 are not available, thereby reducing the complexities associated with the two additional categories, including assessment of intentions and accounting 'penalties' in some cases.

(b) **Derecognition**. The *IFRS for SMEs* establishes a simple principle for derecognition. That principle does not rely on the 'pass-through' and 'continuing involvement' provisions that apply to derecognition under IAS 39. Those provisions are complex and relate to derecognition transactions in which SMEs are typically not engaged.

(c) **Hedge accounting**. The *IFRS for SMEs* focuses on the types of hedging that SMEs are likely to do, specifically hedges of:

(i) interest rate risk of a debt instrument measured at amortised cost.

(ii) foreign exchange risk or interest rate risk in a firm commitment or a highly probable forecast transaction.

(iii) price risk of a commodity that it holds or in a firm commitment or a highly probable forecast transaction to purchase or sell a transaction.

(iv) foreign exchange risk in a net investment in a foreign operation.

(d) **Derivative financial instruments**. The *IFRS for SMEs* does not require separate accounting for 'embedded derivatives'. However, non-financial contracts that include an embedded derivative with economic characteristics not closely related to the host contract are accounted for in their entirety at fair value (see paragraph BC105).

BC102 With regard to hedge accounting, Section 12 requires periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39. In particular, ineffectiveness is recognised and measured at the end of the financial reporting period, and hedge accounting is discontinued prospectively starting from that point, for hedges that no longer meet the conditions for hedge accounting. IAS 39 would require discontinuation of hedge accounting prospectively starting at the date the conditions were no longer met— a requirement that SMEs often say they find burdensome.

BC103 As an alternative to simplified effectiveness testing, the Board considered an approach that is in the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* (Sections 815(20)(25)(102) to 815(20)(25)(117) of the FASB Codification) and is called the 'shortcut method'. Under such a method, the *IFRS for SMEs* would impose strict conditions on the designation of a hedging relationship with subsequent hedge effectiveness assumed without need for measuring ineffectiveness. The Board concluded that simplified effectiveness testing is preferable to the shortcut method for two principal reasons:

(a) Recognition of all hedge ineffectiveness in profit or loss is a basic principle of IAS 39. The shortcut method is inconsistent with that principle.

(b) To be able to assume that the possibility of hedge ineffectiveness is nil or insignificant, the key features of the hedging instrument and the hedged item, including the term, would have to match, and there could be no conditional terms. Consequently, hedge accounting would be prohibited if the hedging instrument is prepayable or puttable or has other early termination or extension features. Such a requirement would, in effect, make hedge accounting a practical impossibility for many, and perhaps most, SMEs.

BC104 Section 12 also differs from IAS 39 with respect to hedge accounting in the following ways:

(a) Hedge accounting cannot be achieved by using debt instruments ('cash instruments') as hedging instruments. IAS 39 permits this for a hedge of a foreign currency risk.

(b) Hedge accounting is not permitted with an option-based hedging strategy. Because hedging with options involves incurring a cost, SMEs are more likely to use forward contracts as hedging instruments than options.

(c) Hedge accounting for portfolios is not permitted. Hedging portfolios adds considerable accounting complexity because of the need to remeasure all of the hedged items individually at fair value to ensure that the appropriate amounts are derecognised when the instrument is sold and to ensure that the amortisation is appropriate when an instrument is no longer being hedged.

The simplification in (a) is appropriate since hedge accounting would not have a significant effect on the financial statements because of the offsetting effects of the accounting for a foreign currency debt instrument under Section 11 and the recognition of exchange differences on most monetary items in profit or loss under Section 30 *Foreign Currency Translation*. In addition, the Board does not believe that the simplifications in (b) and (c) will affect SMEs adversely because these are not hedging strategies that are typical of SMEs.

BC105 Contracts to buy, sell, lease or insure a non-financial item such as a commodity, inventory, property, plant or equipment are accounted for as financial instruments within the scope of Section 12 if they could result in a loss to the buyer, seller, lessor, lessee or insured party as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties. Such contracts are accounted for as financial instruments because their terms include a financial risk component that alters the settlement amount of the contract that is unrelated to the purchase or sale of, or leasing or insuring, the non-financial item.

BC106 The *IFRS for SMEs* gives SMEs a choice of following Sections 11 and 12 or IAS 39 in accounting for all of their financial instruments. The Board's reasons for proposing that choice in this case are as follows:

(a) Although Sections 11 and 12 are a simpler approach to accounting for financial instruments than IAS 39, some of the simplifications involve eliminating options that are available to companies with public accountability under IAS 39, for instance:

(i) the fair value option.

(ii) available-for-sale classification and the available-for-sale option.

(iii) held-to-maturity classification.

(iv) a continuing involvement approach to derecognition (ie partial derecognition).

(v) the use of hedge accounting for hedges other than the four specific types identified in paragraph BC101(c).

The Board is currently reconsidering IAS 39 in its entirety and concluded that SMEs should be permitted to have the same accounting policy options as in IAS 39 pending completion of the comprehensive IAS 39 project.

(b) Because the default category for financial instruments in the scope of Section 12 is fair value through profit and loss under the *IFRS for SMEs*, and cost or amortised cost is permitted only when specified conditions are met, some items measured at cost or amortised cost under IAS 39 because of their nature would be measured at fair value through profit or loss under the *IFRS for SMEs*. Some SMEs might find this added fair valuation burdensome.

(c) Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. Those entities generally believe that the available-for-sale classification of IAS 39 is appropriate to account for strategic investments. Under the *IFRS for SMEs*, however, these strategic investments would be accounted for either at fair value through profit or loss or at amortised cost.

(d) The derecognition provisions of the *IFRS for SMEs* would not result in derecognition for many securitisations and factoring transactions that SMEs may enter into, whereas IAS 39 would result in derecognition.

BC107 The exposure draft had proposed that an entity electing to follow IAS 39 instead of the financial instruments sections of the *IFRS for SMEs* would also have to comply in full with the disclosure requirements of IFRS 7 *Financial Instruments*: *Disclosures*. Many respondents to the exposure draft argued that many of the IFRS 7 disclosures are designed for financial institutions (which are ineligible to use the *IFRS for SMEs*) or for entities whose securities are traded in public capital markets. In their view, the financial instruments disclosures in the *IFRS for SMEs* are appropriate for all SMEs including those that choose to look to IAS 39 for recognition and measurement. The Board found this argument persuasive, and the *IFRS for SMEs* does not require the IFRS 7 disclosures.

Amortisation and impairment of goodwill and other indefinite-lived intangible assets

BC108 In their responses to the recognition and measurement questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the requirement in IAS 36 *Impairment of Assets* for an annual calculation of the recoverable amount of goodwill and other indefinite-lived intangible assets is onerous for SMEs because of the expertise and cost involved. They proposed, as an alternative, that SMEs should be required to calculate the recoverable amount of goodwill and other indefinite-lived intangible assets only if impairment is indicated. They proposed, further, that the *IFRS for SMEs* should include a list of indicators of impairment as guidance for SMEs. The Board agreed with those proposals. Respondents to the exposure draft supported the Board's decision on an indicator

approach to impairment. Consequently, the *IFRS for SMEs* establishes an indicator approach and includes a list of indicators based on both internal and external sources of information. In addition if goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then the *IFRS for SMEs* provides relief by letting the entity test goodwill for impairment by determining the recoverable amount of the acquired entity in its entirety if the goodwill relates to an acquired entity that has not been integrated. If the goodwill relates to an entity that has been integrated into the group, the recoverable amount of the entire group of entities is tested.

BC109 Many respondents to the recognition and measurement questionnaire and participants in the round-table discussions favoured requiring amortisation of goodwill and other indefinite-lived intangible assets over a specified maximum period. Proposals generally ranged from 10 to 20 years. They argued that amortisation is simpler than an impairment approach, even an impairment approach that is triggered by indicators. In developing the exposure draft, the Board did not agree with that proposal for three main reasons:

(a) An amortisation approach still requires assessment of impairment, so it is actually a more complex approach than an indicator-triggered assessment of impairment.

(b) Amortisation is the systematic allocation of the cost of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset over its useful life. By its nature, goodwill often has an indefinite life. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not faithfully represent economic reality.

(c) When the IASB was developing IFRS 3 *Business Combinations* (as revised in 2008) and related amendments to IAS 38 *Intangible Assets*, most users of financial statements said they found little, if any, information content in the amortisation of goodwill over an arbitrary period of years.

Consequently, the exposure draft proposed an impairment-only approach to goodwill and other indefinite-lived intangible assets, combined with an indicator trigger for detailed impairment calculations.

BC110 Many respondents to the exposure draft disagreed with the proposal not to require amortisation of goodwill. In fact, the single accounting recognition and measurement proposal in the exposure draft that was most frequently recommended for reconsideration was non-amortisation of goodwill. The great majority of the respondents addressing this issue recommended that amortisation of goodwill should either be permitted or be required over a limited number of years. Many of those respondents acknowledged the need for impairment testing in addition to, but not as a substitute for, amortisation. Moreover, respondents who held this view also felt that SMEs should not be required to distinguish between intangible assets with finite and indefinite useful lives. At their meeting in April 2008, working group members unanimously supported requiring amortisation of all intangibles, including goodwill, subject to an impairment test.

BC111 Some respondents holding this view acknowledged that amortisation of goodwill and other indefinite-lived intangible assets may not be the most conceptually correct approach. However, from a practical standpoint, they pointed out that many smaller entities will find it difficult to assess impairment as accurately or as promptly as larger or listed entities, meaning the information could be less reliable. Amortisation, particularly if coupled with a relatively short maximum amortisation period, would reduce the circumstances in which an impairment calculation would be triggered. They also pointed out that in the context of SMEs, users of financial statements say they find little, if any, information content in goodwill at all; for example, lenders generally do not lend against goodwill as an asset.

BC112 After considering the various views expressed, the Board concluded—for cost-benefit reasons, rather than conceptual reasons—that goodwill and other indefinite-lived intangible assets should be considered to have finite lives. Therefore, such assets should be amortised over their estimated useful lives, with a maximum amortisation period of ten years. The assets must also be assessed for impairment using the 'indicator approach' in the *IFRS for SMEs*.

Charge all development costs to expense

BC113 IAS 38 requires all research costs to be charged to expense when incurred, but development costs incurred after the project is deemed to be commercially viable are to be capitalised. Many preparers and auditors of SMEs' financial statements said that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis and, furthermore, capitalisation of only a portion of the development costs does not provide useful information. Bank lending officers told the Board that information about capitalised development costs is of little benefit to them, and that they disregard those costs in making lending decisions.

BC114 The Board accepted those views, and the *IFRS for SMEs* requires all research and development costs to be recognised as expenses when incurred.

Cost method for associates and jointly controlled entities

BC115 IAS 28 requires an entity to account for its investments in associates by the equity method. IAS 31 allows an entity to account for its investments in jointly controlled entities by either the equity method or proportionate consolidation. Many preparers of SMEs' financial statements questioned the usefulness of both of those accounting methods and told the Board that SMEs have particular difficulty in applying those methods because of inability to obtain the required information and the need to conform accounting policies and reporting dates. In their view, the cost method—which is permitted under IAS 28 and IAS 31 in accounting for investments in associates and joint ventures in the investor's separate financial statements—should also be permitted under the *IFRS for SMEs* in the investor's consolidated financial statements. Lenders generally indicated that information reported using the equity method and proportionate consolidation is of limited use to them because it is not useful in assessing either future cash flows or loan security. Fair values are more relevant for those purposes. Recognising the special problems of SMEs in applying the equity and proportionate consolidation methods, and also the relevance of fair values for lenders, the Board concluded that SMEs should be permitted to use either the cost method or fair value through profit or loss.

Fair value through profit or loss for associates and jointly controlled entities with published price quotations

BC116 IAS 28 requires investments in associates to be measured using the equity method. IAS 31 requires investments in jointly controlled entities to be measured using either the equity method or proportionate consolidation. Neither of those standards makes an accounting measurement distinction if such investments happen to have a published price quotation.

BC117 The *IFRS for SMEs* requires that any investment in an associate or jointly controlled entity for which there is a published price quotation must be measured at fair value through profit or loss. The Board's reasons for reaching this decision were (a) concerns about measurement reliability are substantially eliminated, (b) the cost of obtaining a fair valuation is substantially eliminated and (c) such fair values are more relevant than cost-based measurements to lenders and other users of SMEs' financial statements.

Non-current assets held for sale

BC118 IFRS 5 defines when non-current assets or groups of assets (and associated liabilities) are 'held for sale' and establishes accounting requirements for such assets. The accounting requirements are, in essence, (a) stop depreciating the asset (or assets in the group) and (b) measure the asset (or group) at the lower of carrying amount and fair value less costs to sell. There is also a requirement to disclose information about all non-current assets (groups) held for sale. The exposure draft of the *IFRS for SMEs* had proposed nearly identical requirements.

BC119 Many respondents to the exposure draft recommended that the *IFRS for SMEs* should not have a separate held-for-sale classification for cost-benefit reasons, and working group members concurred. They felt that an accounting result similar to that of IFRS 5 could be achieved more simply by including intention to sell as an indicator of impairment. Many who held this view also recommended that the *IFRS for SMEs* require disclosure when an entity has a binding sale agreement for a major disposal of assets, or a group of assets or liabilities. The Board agreed with those recommendations because (a) the impairment requirements in the IFRS would ensure that assets are not overstated in the financial statements and (b) the disclosure requirements will provide relevant information to users of SMEs' financial statements.

Borrowing costs

BC120 IAS 23 requires borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised as part of the cost of the asset. For cost-benefit reasons, the *IFRS for SMEs* requires such costs to be charged to expense.

Income tax

BC121 In their responses to the questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the temporary difference approach to accounting for income taxes in IAS 12 *Income Taxes* is difficult for SMEs to implement. They said that SMEs do not routinely prepare 'tax balance sheets' and generally do not track the tax bases of many assets. Some advocated a 'current taxes payable' method of accounting for income taxes, under which SMEs would not recognise deferred taxes.

BC122 The Board did not support the 'current taxes payable' approach for the reasons explained in paragraph BC145. However, while believing that the principle of recognising deferred tax assets and liabilities is appropriate for SMEs, the Board also concluded that implementation of that principle could be simplified for SMEs. Section 29 *Income Tax* of the *IFRS for SMEs* uses the approach set out in the Board's exposure draft *Income Tax*, published in March 2009, which proposes a simplified replacement for IAS 12. The only significant measurement difference in the *IFRS for SMEs* as compared with the exposure draft *Income Tax* is where a different tax rate applies to distributed and undistributed income. The *IFRS for SMEs* requires current and deferred taxes to be measured initially at the rate applicable to undistributed profits, with adjustment in subsequent periods if the profits are distributed. The *Income Tax* exposure draft would initially measure current and deferred taxes at the tax rate expected to apply when the profits are distributed.

Exchange differences on monetary items

BC123 IAS 21 requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a

subsidiary), IAS 21 recognises such exchange differences initially in other comprehensive income and reclassifies them from equity to profit or loss on disposal of the net investment. The *IFRS for SMEs* provides for one difference: an exchange difference that is recognised initially in other comprehensive income is not reclassified in profit or loss on disposal of the investment. The reason for the difference is that not requiring reclassification is less burdensome for SMEs because it eliminates the need for tracking the exchange differences after initial recognition.

Less fair value for agriculture

BC124 Some preparers and auditors of the financial statements of SMEs engaged in agricultural activities said that the 'fair value through profit or loss' model is burdensome for SMEs, particularly when applied to biological assets of those SMEs operating in inactive markets or developing countries. They said that the presumption in IAS 41 that fair value can be estimated for biological assets and agricultural produce is unrealistic with respect to biological assets of some SMEs. Some proposed that SMEs should be permitted or required to use a 'cost-depreciation-impairment' model for all such assets. The Board did not support this approach for the reasons explained in paragraph BC146. However, the Board concluded, both because of the measurement problems in inactive markets and developing countries and for cost-benefit reasons, that SMEs should be required to use the fair value through profit or loss model only when fair value is readily determinable without undue cost or effort. When that is not the case, the Board concluded that SMEs should follow the cost-depreciation-impairment model.

Employee benefits—measurement of the defined benefit obligation

BC125 IAS 19 requires that a defined benefit obligation should always be measured using the projected unit credit actuarial method. For cost-benefit reasons, the *IFRS for SMEs* provides for some measurement simplifications that retain the basic IAS 19 principles but reduce the need for SMEs to engage external specialists. Therefore, the Board decided:

(a) If information based on the projected unit credit calculations of IAS 19 is already available or can be obtained without undue cost or effort, SMEs must use that method.

(b) If information based on the projected unit credit method is not available and cannot be obtained without undue cost or effort, SMEs must apply an approach that is based on IAS 19 but does not consider future salary progression, future service or possible mortality during an employee's period of service. This approach still takes into account life expectancy of employees after retirement age. The resulting defined benefit pension obligation reflects both vested and unvested benefits.

(c) The *IFRS for SME*s clarifies that comprehensive valuations would not normally be necessary annually. In the interim periods, the valuations would be rolled forward for aggregate adjustments for employee composition and salaries, but without changing the turnover or mortality assumptions.

Employee benefits—actuarial gains and losses of defined benefit plans

BC126 One of the principal complexities of IAS 19 is recognition of actuarial gains and losses. Under IAS 19, an entity can choose any of the following options:

(a) recognise actuarial gains and losses in full in profit or loss when they occur.

(b) recognise actuarial gains and losses in full directly in other comprehensive income when they occur.

(c) amortise the excess of actuarial gains and losses over the greater of

(i) 10 per cent of the present value of the defined benefit obligation at that date (before deducting plan assets) and

(ii) 10 per cent of the fair value of any plan assets at that date

(with those limits calculated and applied separately for each defined benefit plan) divided by the average remaining working life of the employees.

(d) recognise actuarial gains and losses in profit or loss using any systematic method that results in faster recognition than (c) above.

BC127 The *IFRS for SMEs* does not permit either of the deferral and amortisation methods described in (c) or (d). Instead, it requires immediate recognition with an option to present the amount either in profit or loss (method (a)) or in other comprehensive income (method (b)). Methods (a) and (b) are far simpler than either of the deferral and amortisation methods. Methods (c) and (d) require tracking of data over many years and annual calculations. Moreover, financial statement users generally have told the Board that they find immediate recognition (methods (a) and (b)) provides the most understandable and useful information.

Employee benefits—unvested past service cost of defined benefit plans

BC128 Past service cost relating to employee service in prior periods arises when a new defined benefit plan is introduced or an existing plan is changed. IAS 19 requires past service cost to be deferred and amortised as an expense (or, in the case of benefit reductions, as income) on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately when a plan is introduced or changed, the past service cost is recognised in profit or loss immediately. The *IFRS for SMEs* requires immediate recognition of all past service cost (including that related to unvested benefits), without any deferral. The Board believes that the method in the *IFRS for SMEs* is simpler because it does not require tracking of data over many years or annual calculations. A deferred recognition model relegates important information about the funding status of post-retirement plans to the notes to the financial statements. Further, deferred recognition treats changes to an entity's pension assets and liabilities differently from changes to the entity's other assets and liabilities.

Share-based payment

BC129 The exposure draft had proposed that SMEs should apply IFRS 2 in measuring equity-settled share-based payment transactions, and that the entity should make the disclosures required by IFRS 2. The Board's reasoning was that IFRS 2 already provided a simplification for SMEs because, if an entity is unable to estimate reliably the fair value of the equity instruments granted at the measurement date, the entity is permitted to measure the equity instruments at intrinsic value. Most respondents to the exposure draft said that the intrinsic value method is not much of a simplification as this method requires knowing the fair value of the underlying shares when the share option (or other share-based payment) is granted and at each subsequent reporting date. The working group shared this concern about IFRS 2.

BC130 The Board considered the views of these respondents and the working group and concluded that further simplifications are appropriate for cost-benefit reasons. As a matter of principle, the Board concluded that SMEs should always recognise an expense for equity-settled share-based payments and that the expense should be measured on the basis of observable market prices, if available. If observable market prices are not available, SMEs should measure the expense using the directors' best estimate of the fair value of the equity-settled share-based payment. The Board also decided that disclosure only, without expense recognition, is not appropriate.

BC131 The Board also decided that for SMEs' share-based payment transactions that give either the entity or the counterparty a choice of settlement in cash or equity instruments, the entity should account for the transaction as a cash-settled share-based payment transaction unless either

(a) the entity has a past practice of issuing equity instruments under similar arrangements, or

(b) the option to settle in cash has no commercial substance.

In circumstances (a) and (b), the transaction is accounted for as equity-settled.

Transition to the *IFRS for SMEs*

BC132 IFRS 1 requires an entity's first IFRS financial statements to include at least one year of comparative information under IFRSs. Some preparers and auditors of SMEs' financial statements explained to the Board that a requirement to prepare restated prior period data in all cases would be burdensome for SMEs adopting the *IFRS for SMEs* for the first time. Thus, the *IFRS for SMEs* includes an 'impracticability' exemption. Similarly, it provides an impracticability exemption with respect to some requirements for restating the opening statement of financial position.

Investment property

BC133 IAS 40 allows an accounting policy choice of either fair value through profit or loss or a cost-depreciation-impairment model (with some limited exceptions). An entity following the cost-depreciation-impairment model is required to provide supplemental disclosure of the fair value of its investment property. The *IFRS for SMEs* does not have an accounting policy choice but, rather, the accounting for investment property is driven by circumstances. If an entity knows or can measure the fair value of an item of investment property without undue cost or effort, it must use the fair value through profit or loss model for that investment property. It must use the cost-depreciation-impairment model for other investment property. Unlike IAS 40, the *IFRS for SMEs* does not require disclosure of the fair values of investment property measured on a cost basis.

Government grants

BC134 The *IFRS for SMEs* requires a single, simplified method of accounting for all government grants. All grants are recognised in income when the performance conditions are met or earlier if there are no performance conditions. All grants are measured at the fair value of the asset received or receivable. IAS 20 permits a range of other methods that are not allowed by the *IFRS for SMEs*.

Exception from straight-line method by lessees for operating leases when payments compensate the lessor for inflation

BC135 The *IFRS for SMEs* does not require a lessee to recognise lease payments under operating leases on a straight-line basis if the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. That exception to the straight-line basis is not in IAS 17 *Leases*.

No annual review of useful life, residual value and depreciation/amortisation method

BC136 The *IFRS for SMEs* does not require an annual review of the useful life, residual value, and depreciation or amortisation method for property, plant and equipment and intangible assets. Instead, a review is required only if there is an indication that there has been a significant change since the last annual reporting date. IAS 16 and IAS 38 require reviews at least at each financial year-end.

Simplifications considered but not adopted

BC137 In developing the *IFRS for SMEs*, the Board considered some recognition and measurement simplifications that it decided not to adopt. Some of those potential simplifications were identified in existing national accounting standards for SMEs. Some were proposed by the Board's constituents in their responses to the 2004 discussion paper or the recognition and measurement questionnaire in 2005. Those proposals, and the Board's reasons for rejecting them, are described in paragraphs BC138–BC150.

Not to require a cash flow statement

BC138 Some suggested that the Board should not require SMEs to prepare a cash flow statement. Some who held this view believed that preparing a cash flow statement is burdensome. Some contended that users of SMEs' financial statements do not find the cash flow statement useful.

BC139 The Board noted that if a comparative statement of financial position (with amounts for the beginning and the end of the reporting period) and an income statement are available, preparing a cash flow statement is not a difficult, time-consuming or costly task. The accounting frameworks of most jurisdictions require broad groups of entities, including SMEs, to prepare a cash flow statement. Moreover, the great majority of users of SMEs' financial statements who have communicated with the Board—including particularly lenders and short-term creditors—indicated that the cash flow statement is very useful to them.

Treat all leases as operating leases

BC140 IAS 17 does not recognise a lessee's rights and obligations under a lease in the statement of financial position if the lease is classified as an operating lease. Although lessees obtain rights and incur obligations under all leases, finance leases create obligations substantially equivalent to those arising when an asset is purchased on credit. Information about such assets and obligations is important for lending and other credit decisions. Treating all leases as operating leases would remove useful information from the statement of financial position.

Treat all employee benefit plans as defined contribution plans

BC141 As with leases, users of financial statements are concerned about 'off balance sheet obligations'. Many jurisdictions require SMEs by law to provide benefits that are the equivalent of a defined benefit pension plan—for example, long-service benefits. Users of SMEs' financial statements consistently say that information about the funding status of such obligations is useful and important to them.

Completed contract method for construction contracts

BC142 The completed contract method can produce a potentially misleading accounting result for a construction contractor, with initial years of no profit at all followed by full recognition of profit when the construction is completed. Many construction contractors are SMEs. The fluctuation between years of large profit and years of large losses may be magnified for SMEs because they tend to have fewer contracts than larger entities. Users of financial statements have told the Board that, for a contractor, the percentage of completion method provides information that they find more useful than the completed contract method.

Fewer provisions

BC143 Provisions are liabilities of uncertain timing or amount. Despite the uncertainties, they are obligations that have met the liability recognition criteria. Users of SMEs' financial statements consistently say they want these obligations recognised in the statement of financial position, with the measurement uncertainties explained.

Non-recognition of share-based payment

BC144 Non-recognition is inconsistent with the definitions of the elements of financial statements, especially an expense. Moreover, users of financial statements generally hold the view that share-based payments to employees should be recognised as remuneration expense because (a) they are intended as remuneration, (b) they involve giving something of value in exchange for services and (c) the consumption of the employee services received is an expense. Although Section 26 requires recognition of the expense, it also provides for simplified measurement as compared with IFRS 2.

Non-recognition of deferred taxes

BC145 Some support the 'taxes payable method' of accounting for income taxes. Under that method, only income taxes currently payable or refundable are recognised; deferred taxes are not recognised. Many users of SMEs' financial statements disagree with the taxes payable method. They point out that deferred taxes are liabilities (or sometimes assets) that can result in large outflows (inflows) of cash in the near future and, therefore, should be recognised. Even those users of financial statements who do not agree that deferred tax liabilities or deferred tax assets should be recognised generally want the amounts, causes and other information disclosed in the notes. Note disclosure would entail the same tracking and computation effort for SMEs as would recognition, but would be inconsistent with the principles for recognising assets and liabilities in the *Framework*. The Board concluded that making a fundamental departure from the recognition principles in IAS 12 while requiring disclosure of the information that users of SMEs' financial statements find useful is not justified on a cost-benefit basis. Moreover, the Board believes that deferred taxes satisfy the requirements for recognition as assets and liabilities and can be measured reliably.

Cost model for all agriculture

BC146 Not only is fair value generally regarded as a more relevant measure in this industry, quoted prices are often readily available, markets are active, and measuring cost is actually more burdensome and arbitrary because of the extensive allocations required. Moreover, managers of most SMEs that undertake agricultural activities say that they manage on the basis of market prices or other measures of current value rather than historical costs. Users also question the meaningfulness of allocated costs in this industry.

No consolidated financial statements

BC147 In many countries, SMEs are organised into two or more legal entities for tax or other legal reasons, even though they operate as one economic entity. Investors, lenders and other users of SMEs' financial statements say that they find information about the financial position, operating results and cash flows of the economic entity useful for their decisions. They say they cannot use the separate financial statements of the legal entities because those entities often enter into transactions with each other that are not necessarily structured or priced on an arm's length basis. In such circumstances, the amounts reported in the separate statements reflect internal transactions (eg sales between the legal entities) that are not transactions of the economic entity with other economic entities. Also, the entities are often jointly managed, and loans are cross-collateralised. In the Board's judgement, consolidated statements are essential for users when two entities operate as a single economic entity.

Recognition of all items of income and expense in profit or loss

BC148 The *IFRS for SMEs* requires SMEs to recognise items of income or expense in other comprehensive income, rather than in profit or loss, in three circumstances:

(a) Paragraph 12.23 requires SMEs to recognise changes in the fair value of some hedging instruments in other comprehensive income.

(b) Paragraph 28.24 gives SMEs the option to recognise actuarial gains and losses either in profit or loss or in other comprehensive income.

(c) Paragraph 30.13 provides that, in consolidated financial statements, SMEs must recognise in other comprehensive income a foreign exchange difference (gain or loss) arising on a monetary item that forms part of the reporting entity's net investment in a foreign operation (subsidiary, associate or joint venture).

BC149 In developing the *IFRS for SMEs*, the Board considered whether to require SMEs to recognise the foreign exchange gains or losses and actuarial gains and losses only in profit or loss, rather than as part of other comprehensive income. Because the *IFRS for SMEs* requires SMEs to present a statement of comprehensive income, the Board concluded not to require presentation of those gains and losses in profit or loss.

BC150 Because the Board has begun a comprehensive project on financial instruments as part of its convergence programme with the US Financial Accounting Standards Board, the Board did not consider requiring SMEs to recognise changes in the fair value of all hedging instruments in profit or loss at this time.

Issues addressed in the *IFRS for SMEs* that are not covered in full IFRSs

BC151 The *IFRS for SMEs* covers several issues that, in the Board's judgement, are relevant to SMEs but are not addressed in full IFRSs:

(a) combined financial statements (paragraphs 9.28–9.30).

(b) original issue of shares or other equity instruments (paragraphs 22.7–22.10).

(c) sale of options, rights and warrants (paragraph 22.11).

(d) capitalisation or bonus issues of shares and share splits (paragraph 22.12).

Optional reversion to full IFRSs by an entity using the *IFRS for SMEs*

BC152 The Board considered whether an entity using the *IFRS for SMEs* should be allowed to choose to apply a recognition or measurement principle permitted in a full IFRS that differs from the principle required by the related section of the *IFRS for SMEs*.

BC153 Some proposed that the *IFRS for SMEs* should, in effect, contain 'optional simplifications of IFRSs'. Within this group, there were two schools of thought:

(a) One school would permit SMEs to revert to full IFRSs principle by principle, while otherwise continuing to use the *IFRS for SMEs*.

(b) The second school would permit SMEs to revert to a full IFRS in its entirety, but not principle by principle within an IFRS, while otherwise continuing to use the *IFRS for SMEs*. Those who hold this view believe that the recognition and measurement principles in a full IFRS are so interrelated that they should be regarded as an integrated package.

BC154 The alternative view is that an entity should be required to choose only either the complete set of full IFRSs or the complete *IFRS for SMEs*. The Board is of that view (with the sole exception of the option to apply IAS 39 for the reasons set out in paragraph BC106). Allowing SMEs optionally to revert to full IFRSs either principle by principle or standard by standard, while continuing to follow the *IFRS for SMEs* for other transactions and circumstances, would result in significant non-comparability. Undesirably, SMEs would have almost an infinite array of combinations of accounting policies from which to choose.

Presentation simplifications

BC155 On the basis of the needs of users of SMEs' financial statements and costs to smaller entities, the Board concluded that the *IFRS for SMEs* should reflect the following simplifications of financial statement presentation:

(a) An entity should not be required to present a statement of financial position as at the beginning of the earliest comparative period when the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. IAS 1 would require such a presentation.

(b) All deferred tax assets and liabilities should be classified as non-current assets or liabilities. The Board's exposure draft *Income Tax* proposes that deferred taxes and liabilities should be classified as either current or non-current according to the classification of the related non-tax asset or liability in the statement of financial position.

(c) An entity is permitted to present a single statement of income and retained earnings in place of separate statements of comprehensive income and changes in equity if the only changes to its equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy. This option does not exist in full IFRSs.

Disclosure simplifications

BC156 The disclosure requirements in the *IFRS for SMEs* are substantially reduced when compared with the disclosure requirements in full IFRSs. The reasons for the reductions are of four principal types:

(a) Some disclosures are not included because they relate to topics covered in IFRSs that are omitted from the *IFRS for SMEs* (see paragraph BC88).

(b) Some disclosures are not included because they relate to recognition and measurement principles in full IFRSs that have been replaced by simplifications proposed in the draft IFRS (see paragraphs BC98–BC136).

(c) Some disclosures are not included because they relate to options in full IFRSs that are not included in the *IFRS for SMEs* (see paragraphs BC84–BC86).

(d) Some disclosures are not included on the basis of users' needs or cost-benefit considerations (see paragraphs BC44–BC47, BC157 and BC158).

BC157 Assessing disclosures on the basis of users' needs was not easy, because users of financial statements tend to favour more, rather than fewer, disclosures. The Board was guided by the following broad principles:

(a) Users of the financial statements of SMEs are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.

(b) Users of the financial statements of SMEs are particularly interested in information about liquidity and solvency. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.

(c) Information on measurement uncertainties is important for SMEs.

(d) Information about an entity's accounting policy choices is important for SMEs.

(e) Disaggregations of amounts presented in SMEs' financial statements are important for an understanding of those statements.

(f) Some disclosures in full IFRSs are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical SMEs.

BC158 The Board also relied on the recommendations of the working group, which undertook a comprehensive review of the disclosure proposals in the exposure draft, and the comments on those proposals in responses to the exposure draft. The working group sent its comprehensive recommendations to the Board in July 2008. In addition, the staff of the German Accounting Standards Committee met representatives of six German banks that lend extensively to small private entities and provided the IASB with a comprehensive report on disclosure needs from a bank lender's perspective.

Why a separate volume rather than added sections in each IFRS

BC159 The Board saw merit in two approaches—publishing the *IFRS for SMEs* in a separate volume and publishing a separate section in each individual IFRS (including Interpretations). The principal advantages of the separate volume are:

(a) ease of use for those seeking to apply the *IFRS for SMEs*. If the *IFRS for SMEs* addresses the transactions, events and conditions typically encountered by SMEs, much of the material in full IFRSs would not normally have application for SMEs.

(b) the *IFRS for SMEs* can be drafted in a simplified language without the details that are needed in full IFRSs.

BC160 The advantages of including the requirements for SMEs as a separate section of each IFRS (including Interpretations) include:

(a) the modifications or exemptions are highlighted.

(b) to the extent that SMEs may choose to look to full IFRSs, putting both the requirements for SMEs and the related full standards in one place is more user-friendly.

(c) it would reduce the likelihood that, in drafting the *IFRS for SMEs*, an unintended difference will arise between an IFRS and the related requirements in the *IFRS for SMEs*.

BC161 Respondents to the discussion paper generally favoured the separate volume approach. On balance the Board agreed for the reasons outlined in paragraph BC159.

Why organisation by topic

BC162 The Board saw merit both in sequentially organising the requirements for SMEs similarly to full IFRSs and in topical organisation. Using the same organisation and numbering system as full IFRSs would enable a user to link back to the full IFRS to seek further guidance on an accounting question. Topical organisation, on the other hand, would make the IFRS for SMEs more like a reference manual, which is likely to be the way that people would use it, and thus it would be more user-friendly. Indexing could minimise the benefits of one of those approaches over the other. Providing the IFRS for SMEs in electronic form could also minimise the benefits of one approach over the other. Most respondents to the discussion paper and the exposure draft favoured organisation by topic. On balance the Board found the benefits of a topically organised reference manual persuasive.

The Board's plan for maintaining (updating) the *IFRS for SMEs*

BC163 In the discussion paper, the Board expressed a tentative view that, 'once the initial *IFRS for SMEs* is in place, concurrently with each exposure draft of an IFRS and each draft Interpretation, and most likely as part of those documents, the Board will propose the related requirements for SMEs. The effective dates of the new or revised requirements for SMEs would probably be the same as the effective date of the new or revised IFRSs (including Interpretations).' In general, respondents to the discussion paper did not agree with this approach. They explained that because SMEs do not have internal accounting resources or the ability to hire accounting advisers on an ongoing basis, the *IFRS for SMEs* should be updated only periodically, perhaps only once in two or three years. They also noted that not every new IFRS or Interpretation or amendment to an IFRS or Interpretation will affect the *IFRS for SMEs*. On the basis of users' needs or cost-benefit considerations, some of those changes may be relevant only for full IFRSs. Furthermore, there may be some changes to the *IFRS for SMEs* that are appropriate even if full IFRSs are not changed.

BC164 The principal benefits of considering changes to the *IFRS for SMEs* at the same time as each new IFRS is proposed or each amendment to an existing IFRS is proposed are consistency of consideration both by the Board and respondents, avoiding a time lag between when changes affect full IFRSs and when similar changes affect the *IFRS for SMEs*, and avoiding potentially differing standards in full IFRSs and the *IFRS for SMEs*.

BC165 On balance, the Board found the arguments set out in paragraph BC163 for periodic, rather than contemporaneous, updating of the *IFRS for SMEs* generally persuasive. Paragraphs P16–P18 of the Preface to the *IFRS for SMEs* explain the Board's plan for maintaining the *IFRS for SMEs*.

Basis for Conclusions on 2015 Amendments to the Standard

Initial comprehensive review (2015)

Background

Reasons for undertaking the initial review

BC166 At the time of issuing the *IFRS for SMEs*, the IASB stated its plan to undertake an initial comprehensive review of the *IFRS for SMEs* that would enable it to assess the experience that entities had had in implementing this Standard and to consider whether there was a need for any amendments. Jurisdictions did not start using the *IFRS for SMEs* on a consistent date. However, by 2010, entities in several jurisdictions had adopted this Standard. Consequently, the IASB decided to commence its initial comprehensive review in 2012. The IASB also stated that, after the initial review, it expected to consider amendments to the *IFRS for SMEs* approximately once every three years. Paragraph BC264 covers the IASB's discussion about the procedure for future reviews of the *IFRS for SMEs*.

Request for Information (RFI)

BC167 In June 2012 the IASB issued a Request for Information (the 'RFI') as the first step in its initial comprehensive review. The RFI was developed together with the SME Implementation Group (SMEIG). The SMEIG is an advisory body to the IASB that was set up by the IFRS

Foundation in 2010. The objective of the SMEIG is to support the international adoption of the *IFRS for SMEs* and monitor its implementation.

BC168 The objective of the RFI was to seek the views of those who had been applying the *IFRS for SMEs*, those who had been using financial information prepared in accordance with the *IFRS for SMEs* and all other interested parties on whether there is a need to make any amendments to it and, if so, what amendments should be made. The RFI did not contain any preliminary views of the IASB or the SMEIG. The IASB received 89 comment letters on the RFI. A detailed summary of the comment letter analysis was provided to SMEIG members at their February 2013 meeting and to IASB members in the agenda papers for its March–May 2013 meetings. These agenda papers are available on the IASB website (www.ifrs.org).

Exposure Draft (2013 ED)

BC169 In October 2013 the IASB issued an Exposure Draft of proposed amendments to the *IFRS for SMEs* (the '2013 ED'). After considering the feedback it had received on the RFI, and taking into consideration the fact that the *IFRS for SMEs* is still a new IFRS, the IASB proposed to only make relatively limited amendments to the *IFRS for SMEs*.

BC170 In total, the IASB proposed 57 amendments in the 2013 ED. With the exception of the proposed amendments to Section 29, each individual amendment only affected a few sentences or words in the *IFRS for SMEs*. Furthermore, most of the proposed amendments were intended to clarify existing requirements or add supporting guidance, instead of proposing changes to the underlying requirements in the *IFRS for SMEs*. Consequently, for most SMEs, the proposals were expected to improve understanding of the existing requirements, without necessarily resulting in changes in practice or changes that would affect the financial statements.

BC171 The IASB received 57 comment letters on the 2013 ED. A detailed summary of the comment letter analysis was provided to the IASB at its May 2014 meeting and to the SMEIG in July 2014. During March–May 2014, the staff also performed additional user outreach with providers of finance to SMEs to supplement the views it had received from other interested parties on the RFI and the 2013 ED. A summary of this outreach was provided to the IASB in October 2014. These summaries are available in the agenda papers on the IASB website.

SMEIG recommendations

BC172 In February 2013 the SMEIG met to discuss the comments received on the RFI and to develop a report of recommendations for the IASB on possible amendments to the *IFRS for SMEs*. The report was published on the IASB website in March 2013. In July 2014 the SMEIG also considered the public comments received on the 2013 ED and developed a second report of recommendations for the IASB on the proposals in the 2013 ED. The second report was published on the IASB website in October 2014. All but one of the recommendations that were supported by a majority of SMEIG members in the second report are consistent with the IASB's decisions during its redeliberations on the 2013 ED. The exception is regarding permitting the revaluation model for property, plant and equipment for which the views of SMEIG members were almost evenly split.

Changes to the proposals in the 2013 ED

BC173 Most respondents to the 2013 ED supported the majority of the changes proposed in the 2013 ED. The following is a summary of the main issues raised by respondents:

(a) the most common concern was the decision of the IASB not to propose an accounting policy option for the revaluation of property, plant and equipment. Some respondents also expressed concern that the IASB had not proposed options to capitalise development and borrowing costs (see paragraphs BC208–BC214).

(b) many respondents commented on the IASB's proposed approach for dealing with new and revised full IFRS Standards (see paragraphs BC185–BC207). The following were the most common issues raised:

(i) the criteria used for assessing changes to full IFRS should be clarified.

(ii) some respondents said changes to the *IFRS for SMEs* should not be introduced until sufficient implementation experience exists under full IFRS. In contrast, others said that the *IFRS for SMEs* should be closely aligned with full IFRS without a long time lag.

(iii) to better identify the needs of users of SME financial statements.

(iv) the simplifications under IAS 19, issued in June 2011, should be incorporated during this review.

(c) many respondents commented on the scope of the *IFRS for SMEs* (see paragraph BC178–BC184 and BC191–BC193). The following were the most common issues raised:

(i) the scope should not be restricted to non-publicly accountable entities;

(ii) there is a disparity between the scope (all non-publicly accountable entities)and the primary aim of the IASB in developing the *IFRS for SMEs* in the 2013 ED (repeated in paragraph BC187), which is seen to be a focus on smaller/less complex non-publicly accountable entities; and

(iii) the *IFRS for SMEs* is too complex for small owner-manager entities.

(d) most respondents supported aligning Section 29 with IAS 12. However, about half of these respondents also suggested simplifications or modifications to the proposals (see paragraphs BC219–BC223).

(e) relatively few respondents commented on many of the other proposed amendments in the 2013 ED or had other comments on specific requirements in the *IFRS for SMEs*. However, the IASB redeliberated the following issues, which were the main ones upon which respondents had comments:

(i) application of 'undue cost or effort' (proposed amendment (PA) 3 in the 2013 ED)—see paragraph BC233;

(ii) definition of basic financial instruments (PA 14)—see paragraph BC246;

(iii) requirements for estimating the useful life of goodwill/other intangible assets (PA 21/26)—see paragraph BC247;

(iv) exemption from requirements for offsetting income tax assets and liabilities (PA 45)—see paragraph BC222;

(v) consolidation of group entities with different reporting dates (PA 9)—see paragraph BC255(f);

(vi) use of undue cost or effort exemption in a business combination (PA 25)—see paragraph BC241;

(vii) accounting for extractive activities (PA 49)—see paragraphs BC224–BC226;

(viii) grouping items in other comprehensive income (PA 6)—see paragraph BC203;

(ix) cumulative exchange differences on the disposal of a subsidiary (PA 10)—see paragraph BC234;

(x) disclosure of accounting policy for termination benefits (PA 43)—see paragraph BC253;

(xi) subsidiaries acquired and held for sale (PA 8)—see paragraph BC255(e);

(xii) distribution of non-cash assets (PA 34)—see paragraph BC239;

(xiii) best evidence of fair value (PA 15)—see paragraph BC255(k); and

(xiv) classification of spare parts (PA 20)—see paragraph BC205.

(f) most respondents supported the proposals in the 2013 ED for the transition requirements and the effective date. However, a significant minority thought that there should be relief from full retrospective application for some or all the proposed amendments, in particular for proposed changes to Section 29 (see paragraph BC256–BC263).

BC174 The result of the IASB's redeliberations of the issues raised is that three significant changes and ten other changes, excluding minor drafting changes, have been made to the proposals in the 2013 ED.

BC175 The three significant changes are:

(a) permitting a revaluation model for property, plant and equipment (see paragraphs BC208–BC212);

(b) simplified transition requirements (see paragraphs BC256–BC260); and

(c) aligning the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6 *Exploration for and Evaluation of Mineral Resources* (see paragraphs BC224–BC226).

BC176 The other changes are:

(a) requiring that for each undue cost or effort exemption in the *IFRS for SMEs*, an SME should disclose when it has used the exemption and its rationale for doing so;

(b) requiring investment property measured at cost less accumulated depreciation and impairment to be presented separately on the face of the statement of financial position;

(c) adding clarifying guidance on the accounting for a subsidiary acquired with the intention of sale or disposal within one year if the subsidiary is not sold or disposed of during that time frame;

(d) permitting an SME to account for investments in subsidiaries, associates and jointly controlled entities in its separate financial statements using the equity method, based on similar changes in *Equity Method in Separate Financial Statements* (Amendments to IAS 27), issued in August 2014;

(e) clarifying the criterion for basic financial instruments in paragraph 11.9 of the *IFRS for SMEs* and adding examples of simple loan arrangements meeting that criterion;

(f) the addition of the exemption in paragraph 70 of IAS 16, which allows an entity to use the cost of the replacement part as an indication of what the cost of the replaced part was at the time that it was acquired or constructed, if it is not practicable to determine the carrying amount of a part of an item of property, plant and equipment that has been replaced;

(g) adding an undue cost or effort exemption from the requirement to measure the liability to pay a non-cash dividend at the fair value of the non-cash assets to be distributed;

(h) a few further modifications to Section 29, including clarifying the wording in the exemption from the requirements for offsetting income tax assets and liabilities;

(i) amending the definition of a related party to include a management entity providing key management personnel services, based on similar changes in *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013; and

(j) not modifying the definition of a financial liability as proposed in the 2013 ED to incorporate *Classification of Rights Issues* (Amendments to IAS 32), issued in October 2009.

BC177 Paragraphs BC178–BC234 and BC264 cover the IASB's discussion about the main issues identified during the comprehensive review and how they were resolved. Paragraphs BC235–BC255 list all the changes made to the *IFRS for SMEs* and provide the IASB's rationale for making those changes to the extent the explanation is not already covered in

BC178–BC234. Paragraphs BC256–BC263 explain the IASB's considerations in setting the transition requirements and the effective date. Paragraphs BC265–BC272 provide an analysis of the likely effects of the amendments.

Main issues identified during the initial comprehensive review

Scope of the *IFRS for SMEs*

BC178 The IASB first addressed the issues relating to the scope. The IASB noted that it was important to clarify the entities for which the *IFRS for SMEs* is intended before deciding what kind of amendments to the *IFRS for SMEs* should be made.

Use of the IFRS for SMEs *by publicly accountable entities*

BC179 Some respondents to the RFI and the 2013 ED said that the scope should not be restricted to non-publicly accountable entities. Consequently, the IASB considered whether paragraph 1.5 of the *IFRS for SMEs* is too restrictive and whether jurisdictions should have the authority to decide whether publicly accountable entities should be able to use and state compliance with the *IFRS for SMEs*.

BC180 The IASB observed that the *IFRS for SMEs* was specifically designed for SMEs and users of SME financial statements and so it may not be appropriate for a wider group of entities. Furthermore, the IASB noted that if the scope was widened to include some publicly accountable entities, it may lead to pressure to make changes to the *IFRS for SMEs* to address issues that may arise from that wider group, which would increase the complexity of the *IFRS for SMEs*. The IASB also had concerns about the risks associated with the inappropriate use of the *IFRS for SMEs* if the restriction on publicly accountable entities using the *IFRS for SMEs* was removed from paragraph 1.5 of the *IFRS for SMEs*. A majority of IFRS Advisory Council and SMEIG members shared the IASB's concerns and recommended keeping the requirement in paragraph 1.5 that prevents publicly accountable entities from stating compliance with the *IFRS for SMEs*.

BC181 After considering the responses to the 2013 ED, the IASB decided that there was no new information that would lead the IASB to reconsider its previous decision. Consequently, it decided to keep paragraph 1.5 of the *IFRS for SMEs*. The IASB noted that jurisdictions can already incorporate the *IFRS for SMEs* into their local GAAP if they wish to allow certain publicly accountable entities to use it. However, those entities would state compliance with local GAAP, not with the *IFRS for SMEs*.

Meaning of fiduciary capacity

BC182 Some respondents to the RFI said that the meaning of 'fiduciary capacity' in the definition of public accountability is unclear, because it is a term that has different implications in different jurisdictions. However, respondents generally did not suggest alternative ways of describing public accountability or indicate what guidance would help to clarify the meaning of fiduciary capacity. Consequently, the IASB asked a question in the 2013 ED to find out more information about the concerns raised.

BC183 Most respondents to the 2013 ED said that there is no need to clarify or replace the term fiduciary capacity. However, a few respondents noted that the term had created uncertainty on the implementation of the *IFRS for SMEs* in their jurisdictions. The IASB observed that it would be difficult to provide a definition of the term fiduciary capacity and/or provide guidance that would be applicable in all jurisdictions applying the *IFRS for SMEs* because of the different legal requirements and types of entities in different jurisdictions. Furthermore, the IASB noted that local legislative and regulatory authorities, and standard-setters in individual jurisdictions, may be best placed to identify the kinds of entities in their jurisdiction that hold assets in a fiduciary capacity for a broad group of outsiders as a primary business. By this,

the IASB does not mean that those authorities and standard-setters are best placed to choose which entities in their jurisdiction meet the criterion in paragraph 1.3(b) of the *IFRS for SMEs*. Instead, the IASB's intention was to ensure that the definition in paragraph 1.3 is applied consistently in accordance with the intended scope of the *IFRS for SMEs* in their jurisdiction. Furthermore, the IASB noted that those local authorities and standard-setters are also best placed to decide whether other factors may mean that, in their jurisdiction, full IFRS may be more suitable for certain SMEs than the *IFRS for SMEs*. Consequently, the IASB decided not to provide guidance on applying the term fiduciary capacity.

Use of the IFRS for SMEs *by not-for-profit entities*

BC184 Some interested parties have asked whether soliciting and accepting contributions would automatically make a not-for-profit (NFP) entity publicly accountable, because such an activity involves the entity holding financial resources entrusted to it by clients. The IASB noted that an entity only has public accountability if it meets the criteria in paragraph 1.3 of the *IFRS for SMEs*. The IASB further noted that paragraph 1.4 lists charitable organisations as an example of an entity that is not automatically publicly accountable if it only holds financial resources entrusted to it by others for reasons incidental to a primary business. The IASB therefore decided that the *IFRS for SMEs* is sufficiently clear that soliciting and accepting contributions does not automatically make NFP entities publicly accountable.

New and revised IFRS Standards

Introduction

BC185 The *IFRS for SMEs* was developed using full IFRS as a starting point and then considering what modifications are appropriate in the light of the needs of users of SME financial statements and cost-benefit considerations (see paragraphs BC95–BC97). Consequently, one of the most significant issues confronting the IASB was how the *IFRS for SMEs* should be updated in the light of the new and revised full IFRS Standards issued after the *IFRS for SMEs* was issued in 2009—in particular, how to balance the importance of maintaining alignment with full IFRS with having a stable, independent and stand-alone Standard that focuses on the needs of SMEs.

BC186 Respondents to the RFI and the 2013 ED were divided on how the *IFRS for SMEs* should be updated during this comprehensive review for new and revised full IFRS Standards. The views expressed by respondents were generally influenced by the respondent's understanding of the purpose of the *IFRS for SMEs* and which entities it should cater for, for example:

(a) some respondents noted that the *IFRS for SMEs* should cater for subsidiaries that are eligible to use the *IFRS for SMEs* but that need to provide full IFRS information for consolidation purposes. Other respondents thought that the *IFRS for SMEs* should act as an intermediate Standard for a company that expects to transition to full IFRS in the future. Both groups of respondents would prefer the *IFRS for SMEs* to be fully aligned with full IFRS, ideally without any time lag, with simplifications from full IFRS being restricted to disclosure requirements.

(b) other respondents noted that the primary aim of the *IFRS for SMEs* is an independent Standard tailored for smaller businesses. Those respondents said that maintaining alignment with full IFRS is less important and also that it is more important to have the implementation experience of new and revised full IFRS Standards first before introducing those requirements for SMEs.

The IASB's principles for dealing with new and revised full IFRS Standards

BC187 The IASB observed that the primary aim when developing the *IFRS for SMEs* was to provide a stand-alone, simplified set of accounting principles for entities that do not have public accountability and that typically have less complex transactions, limited resources to apply full IFRS and that operate in circumstances in which comparability with their listed peers is not an important consideration. The IASB also noted its decision not to extend the scope of the *IFRS for SMEs* to permit publicly accountable entities to use it.

BC188 With this primary aim in mind the IASB considered a framework for how to deal with new and revised full IFRS Standards during this comprehensive review and future reviews of the *IFRS for SMEs*. The IASB developed the following principles:

(a) each new and revised full IFRS Standard should be considered individually on a case-by-case basis to decide if, and how, its requirements should be incorporated into the *IFRS for SMEs*.

(b) new and revised full IFRS Standards should not be considered until they have been issued. However, it would generally not be necessary to wait until their Post-implementation Reviews (PIRs) have been completed.

(c) minor changes/annual improvements to full IFRS should also be considered on a case-by-case basis.

(d) changes to the *IFRS for SMEs* could be considered at the same time that new and revised full IFRS Standards are issued. However, the *IFRS for SMEs* would only be updated for those changes at the next periodic review of the *IFRS for SMEs*, in order to provide a stable platform for SMEs.

BC189 The IASB further observed that, when applying the principles in paragraph BC188, decisions both on which changes to incorporate into the *IFRS for SMEs* and the appropriate timing for incorporating those changes should be weighed against the need to provide SMEs with a stable platform and the suitability of such changes for SMEs and users of their financial statements. The IASB noted that it may decide only to incorporate changes from a complex new or revised full IFRS Standard after implementation experience has been assessed. However, the IASB will make this assessment at the periodic review following the issue of a new or revised full IFRS Standard instead of automatically waiting until there is substantial experience from entities who have applied it or until a PIR of that full IFRS Standard has taken place.

BC190 The IASB decided that new and revised full IFRS Standards should not be considered until they have been issued. This is because, until a final full IFRS Standard is issued, the IASB's views are always tentative and subject to change.

BC191 Some respondents to the 2013 ED expressed concern that the IASB's primary aim in developing the *IFRS for SMEs*, as set out in paragraph BC187, means that the reporting needs of 'large', complex non-publicly accountable entities are not effectively addressed. The IASB agreed that the *IFRS for SMEs* is intended for all SMEs, which are defined to be those entities that do not have public accountability that are required, or elect, to publish general purpose financial statements for external users. The IASB noted that its reasons for developing a Standard intended for all SMEs are explained in paragraphs BC55–BC77. Nevertheless, the IASB observed that when deciding on the content of the *IFRS for SMEs*, the primary aim of the IASB was to focus on the kinds of transactions, events and conditions encountered by typical SMEs that are likely to apply the *IFRS for SMEs*. If the IASB had tried to cater for all possible transactions that SMEs may enter into, the *IFRS for SMEs* would have had to retain most of the content of full IFRS. In particular, the IASB bore in mind that many SMEs have limited resources and that the *IFRS for SMEs* should accommodate that limitation. Conversely, entities with more complex transactions and activities, including SMEs, are likely to have more sophisticated systems and greater resources to manage those transactions.

BC192 If an SME has very complex transactions or determines that comparability with its publicly accountable peers is of key importance to its business, the IASB observed that it would expect that the entity would want to, and have sufficient expertise to, either refer to the more

detailed guidance on complex transactions in full IFRS if specific guidance is not provided in the *IFRS for SMEs* (see paragraph 10.6) or apply full IFRS instead of the *IFRS for SMEs*. Paragraphs BC69–BC70 explain why it is not possible for the IASB to set additional criteria that would be appropriate across all jurisdictions for entities that may find full IFRS more appropriate to their needs. However, jurisdictions may choose to establish size criteria or decide that entities that are economically significant in that country should be required to use full IFRS instead of the *IFRS for SMEs*.

BC193 Some respondents to the 2013 ED said that the *IFRS for SMEs* was too complex for owner-managed entities. The IASB noted that the *IFRS for SMEs* is intended for entities that choose, or are required, to publish general purpose financial statements. General purpose financial statements are those directed to the general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. The Preface to the *IFRS for SMEs* explains that SMEs often produce financial statements only for the use of owner-managers or only for the use of tax authorities or other governmental authorities, and that financial statements produced solely for those purposes are not necessarily general purpose financial statements. The IASB noted that the *IFRS for SMEs* is not intended for small owner-managed entities preparing financial statements solely for tax reasons or to comply with local laws. However, small owner-managed entities may still find the *IFRS for SMEs* helpful in preparing such financial statements.

BC194 Some respondents to the 2013 ED said that the IASB should establish a formal framework or clearer principles to determine whether and when changes to full IFRS should be incorporated in the *IFRS for SMEs*. These respondents noted that the principles developed by the IASB in paragraph BC188 are not robust enough and/or do not help interested parties to predict when changes to full IFRS will be considered. Some respondents provided suggestions that they thought would improve the criteria. The IASB noted that there are special considerations applicable to this initial review of the *IFRS for SMEs*, which led the IASB to place greater emphasis on the need for limiting changes. However, the IASB will discuss to what extent a more developed framework for future reviews of the *IFRS for SMEs* should be established before the next periodic review of the *IFRS for SMEs*.

BC195 Some respondents to the 2013 ED said that they found it difficult to understand the conceptual basis for differences between the *IFRS for SMEs* and full IFRS and that the IASB should clearly identify the needs of users of SME financial statements. The IASB noted that this Basis for Conclusions is clear on both of these points. In particular:

(a) paragraph BC95 notes that the *IFRS for SMEs* was developed by considering the modifications that are appropriate to full IFRS in the light of users' needs and cost-benefit considerations; and

(b) paragraphs BC44–BC47 and BC157 describe the needs of users of SME financial statements and explain how they differ from the needs of users of financial statements of publicly accountable entities.

BC196 Some respondents to the 2013 ED said that if cost-benefit considerations are a major driver of the differences between the *IFRS for SMEs* and full IFRS, public accountability is not an appropriate criterion. The IASB agrees that the related costs of publicly and non-publicly accountable entities may not differ significantly. However, it noted that the 'benefits' side of the cost-benefit trade-off considers the different information needs of different financial statement users as explained in paragraphs BC44–BC47.

Individual new and revised full IFRS Standards during the current review

BC197 The IASB considered how to deal with individual new and revised full IFRS Standards during this comprehensive review in the light of the principles in paragraph BC188. The IASB observed that this comprehensive review is subject to additional considerations compared to future reviews, because it is the first review since the initial publication of the *IFRS for SMEs*. Although the *IFRS for SMEs* was issued in 2009, in many of the jurisdictions that have adopted it, it has been effective for a shorter period of time. In addition, in jurisdictions that permit, instead of require, the *IFRS for SMEs*, many SMEs have only started the transition to

it. As a result, for the majority of SMEs using, or about to use, the *IFRS for SMEs*, it is still a new Standard. For these reasons, the IASB decided that there is a greater need for stability during this initial review than there may be in future reviews. A majority of IFRS Advisory Council members also recommended prioritising the need to provide SMEs with a stable, independent and stand-alone Standard over maximising alignment with full IFRS.

IFRS 3 (2008), IFRS 10, IFRS 11, IFRS 13 and IAS 19 (2011)

BC198 The IASB first considered how to propose to address the five new or revised full IFRS Standards in the 2013 ED that the IASB believed had the potential to result in the most significant changes to the *IFRS for SMEs*, namely IFRS 3 (2008), IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 13 *Fair Value Measurement* and IAS 19 (2011). During development of the 2013 ED, the IASB made the following observations:

(a) IFRS 10, IFRS 11 and IFRS 13 only recently became effective and they introduce complex changes that are expected to result in, and benefit from, significant implementation guidance in practice. Furthermore, they would be expected to have a limited practical impact on the majority of SMEs, because the new requirements are unlikely to affect many common fair value measurements and the accounting for groups of entities with a simple group structure.

(b) the main change in IAS 19 (2011), if incorporated for SMEs, would be a requirement to present actuarial gains and losses in other comprehensive income. As part of its *Conceptual Framework* project, the IASB is currently considering its treatment of other comprehensive income and this may result in changes to the requirements relating to other comprehensive income under full IFRS. Given these possible changes, the IASB decided that it may be better to continue to permit SMEs the choice of recognising actuarial gains and losses in profit or loss or other comprehensive income until this subject has been discussed further.

(c) the changes in IFRS 3 (2008) would result in significant complexity for SMEs, particularly because of the additional fair value measurements required. Based on feedback from the RFI, SMEIG members and other interested parties, the current approach in the *IFRS for SMEs* (based on IFRS 3 (2004)) is working well in practice and is well understood and accepted by preparers and users of SME financial statements. Furthermore, it has the same basic underlying approach as IFRS 3 (2008) but simplified.

For the reasons outlined in this paragraph and in paragraph BC197, the IASB decided not to amend the *IFRS for SMEs* during this initial review to incorporate IFRS 3 (2008), IFRS 10, IFRS 11, IFRS 13 and IAS 19 (2011).

BC199 Apart from those that support full alignment with full IFRS (see paragraph BC186), very few respondents to the 2013 ED had specific comments on the IASB's decision not to incorporate IFRS 3 (2008), IFRS 10, IFRS 11 and IFRS 13. In contrast, several respondents said that the IASB should reconsider its decision not to incorporate some of the changes introduced by IAS 19 (2011) during this comprehensive review. Those respondents asserted that some of the changes introduced by IAS 19 (2011) would simplify the requirements in the *IFRS for SMEs* while at the same time increasing consistency with full IFRS.

BC200 The IASB observed that the new and revised full IFRS Standards that are being incorporated during this review would only make minimal changes to the *IFRS for SMEs* for the majority of SMEs (see paragraphs BC201–BC207). This would not be the case for IAS 19 (2011). Furthermore, the IASB did not think that it would be appropriate to incorporate only one or two of the changes made by IAS 19 (2011), for example, those that may provide a simplification for SMEs such as the basis of the calculation of net interest, without considering the other changes. Section 28 *Employee Benefits* is currently based on IAS 19 before it was amended in 2011. Incorporating only one or two of the changes introduced by IAS 19 (2011) risks developing a mixed model of the old and new IAS 19 for employee

benefits. The IASB noted that this could lead to confusion and result in inconsistencies in the *IFRS for SMEs*.

Other new and revised full IFRS Standards issued before the 2013 ED was published

BC201 The IASB then considered how to propose to address other changes introduced by other new and revised full IFRS Standards in the 2013 ED. Based on an individual assessment of each new and revised full IFRS Standard, the IASB decided that the main changes in the following new and revised full IFRS Standards should be incorporated:

(a) *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1), issued in June 2011;

(b) IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*, issued in November 2009; and

(c) two amendments to IFRS 1:

(i) *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters*, issued in December 2010; and

(ii) *Government Loans*, issued in March 2012.

BC202 The IASB selected the new and revised full IFRS Standards specified in paragraph BC201 based on selecting changes that are relevant to SMEs; provide additional clarity or a simplification, and/or fix known or expected problems or diversity in practice. Furthermore, the IASB noted that each of the new or revised full IFRS Standards listed in paragraph BC201 is likely to only modify one or two paragraphs in the *IFRS for SMEs* and so the resulting changes will be minimal and are consistent with maintaining stability during the early years of implementing the *IFRS for SMEs*. When incorporating the main changes in these new and revised full IFRS Standards the IASB also decided to make two further changes:

(a) to complement the changes made regarding the presentation of items of other comprehensive income, the IASB decided to clarify that the *IFRS for SMEs* does not prescribe how, when or if amounts can be transferred between components of equity (see paragraph 2.22 of the *IFRS for SMEs*).

(b) the IASB noted that the measurement of unquoted equity instruments is often very difficult for SMEs because it involves substantial judgement and complex calculations. The IASB also observed that it would usually expect that the benefits to users of an SME's financial statements of having fair value information about the SME's equity instruments would not justify the SME spending undue cost or effort to provide the information. Consequently, the IASB decided to include an undue cost or effort exemption from the requirement to measure own equity instruments at fair value in IFRIC 19, but to otherwise align the requirements with IFRIC 19.

BC203 Some respondents to the 2013 ED noted that they did not think the change in paragraph BC201(a) was useful for users of SME financial statements, because of the limited circumstances in which items are recognised in other comprehensive income under the *IFRS for SMEs*. These respondents also asserted that incorporating this amendment was inconsistent with the IASB's decision during development of the 2013 ED not to reconsider the use of other comprehensive income during this comprehensive review, because it is considering the treatment of other comprehensive income as part of its *Conceptual Framework* project. However, the IASB observed that the grouping of items of other comprehensive income would be easy for SMEs to apply and the resulting information would have useful predictive value. Consequently, it decided that the change is appropriate for cost-benefit reasons. The IASB also noted that its decision to include an option for SMEs to apply a revaluation model for property, plant and equipment (see paragraph BC210–BC212) will mean that more SMEs may have one or more items recognised in other comprehensive income.

BC204 The IASB also decided that the main changes in the following annual improvements should be incorporated in the *IFRS for SMEs* because they are relevant to SMEs and they provide clarity and, in most cases, simplification:

(a) *Improvements to IFRSs*, issued in May 2010:

(i) revaluation basis as deemed cost (IFRS 1);

(ii) use of deemed cost for operations subject to rate regulation (IFRS 1); and

(iii) clarification of statement of changes in equity (IAS 1).

(b) *Annual Improvements to IFRSs 2009–2011 Cycle*, issued in May 2012:

(i) repeated application of IFRS 1 (IFRS 1);

(ii) classification of servicing equipment (IAS 16); and

(iii) tax effect of distributions to holders of equity instruments (IAS 32).

BC205 Some respondents to the 2013 ED said that the cost and effort of monitoring and tracking the individual spare parts, stand-by equipment and servicing equipment as either property, plant and equipment or inventory (in paragraph BC204(b)(ii)) would not justify the benefits to users of SME financial statements. The IASB observed that the change only clarifies what has always been required by Section 17 *Property, Plant and Equipment*. The IASB also thinks that the changes to the wording in paragraph 17.5 of the *IFRS for SMEs* make the requirements easier to understand.

New and revised full IFRS Standards issued since the 2013 ED was published

BC206 The IASB observed that during reviews of the *IFRS for SMEs*, it would generally consider only new and revised full IFRS Standards published after the related Exposure Draft of proposed amendments to the *IFRS for SMEs* has been issued if they address an urgent need for SMEs or users of their financial statements. This is because if the IASB makes fundamental changes to the proposals in an Exposure Draft, on which respondents have not had the opportunity to comment, this would probably result in the need to re-expose the proposals. By the end of the re-exposure period there would be another list of new and revised full IFRS Standards to consider. On this basis, the IASB noted that it would make only two changes as a result of new and revised full IFRS Standards issued since the 2013 ED was published:

(a) the amendment to the definition of a related party for a management entity providing key management personnel services in *Annual Improvements to IFRSs 2010–2012 Cycle*. The IASB noted that the 2013 ED proposed to align the definition of a related party with IAS 24 *Related Party Transactions* during this comprehensive review and this minor change would allow full alignment.

(b) the main change under *Equity Method in Separate Financial Statements* (Amendments to IAS 27), ie permitting entities to use the equity method to account for subsidiaries, associates and jointly controlled entities in the separate financial statements. The IASB noted that this change would not affect an SME's primary financial statements and that the *IFRS for SMEs* does not require the preparation of separate financial statements. Consequently, the IASB decided to permit SMEs this flexibility if they prepare such additional financial statements.

BC207 Some respondents to the 2013 ED said that it was important for the IASB to consider *Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41), issued in June 2014, that permits a cost model for bearer plants, a subset of biological assets, during this comprehensive review. However, the IASB noted that the *IFRS for SMEs* only requires an entity to account for a biological asset using the fair value model if its fair value is readily determinable without undue cost or effort. The amendments to IAS 16 and IAS 41 responded to concerns raised by some plantation companies that, under certain circumstances, the fair value measurements of bearer plants are complex and costly in the absence of active markets for those assets. In the circumstances in which this is the case, the IASB noted that

the undue cost or effort exemption should be considered by SMEs. Consequently, the IASB does not think that there is an urgent need to make an exemption to incorporate the changes under *Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41) during this comprehensive review.

Accounting policy options

BC208 The IASB noted that users of SME financial statements that need to understand the accounting policies used, and that make comparisons between different SMEs, have said that they prefer SMEs to have no, or only limited, accounting policy options. Furthermore, the IASB noted that while SMEs could still choose to apply the simpler option, adding complex options to the *IFRS for SMEs* would add complexity throughout the Standard. Consequently the IASB continues to support its original reasons for restricting accounting policy options in the *IFRS for SMEs* as set out in paragraphs BC89–BC94.

BC209 The staff's outreach to providers of finance, who are considered to be the primary external user group of SMEs, confirmed the importance to that user group of restricting accounting policy options for SMEs. The participants in the outreach noted that they generally input the information from the audited financial statements of an SME directly into their models when making lending decisions. Consequently, it is important to these parties that SMEs should provide comparable information and that they do not need to make adjustments to that information.

Revaluation model for property, plant and equipment

BC210 The most common concern raised by respondents to the 2013 ED was the decision of the IASB not to propose an accounting policy option for the revaluation of property, plant and equipment. The IASB has received feedback from preparers, standard-setters, accounting firms and other interested parties that not having a revaluation option is a barrier to the adoption of the *IFRS for SMEs* in jurisdictions in which SMEs commonly revalue their property, plant and equipment and/or are required by law to revalue property, plant and equipment. Those interested parties note that, for entities that are currently applying the revaluation model under local GAAP, a change to the cost model may have implications for current borrowing arrangements and affect their ability to raise finance in the future. Furthermore, some respondents have noted that a revaluation option is important in jurisdictions that are experiencing high inflation. Approximately half of the members of the SMEIG also recommended that the IASB should reconsider its proposal not to permit a revaluation model for property, plant and equipment.

BC211 During its redeliberations on the 2013 ED, and in the light of the ongoing and widespread concerns raised by respondents, the IASB decided to permit an option for SMEs to revalue property, plant and equipment. Although the IASB thinks that limiting options is important for the reasons given in paragraphs BC208–BC209, it acknowledges that, based on the responses to the RFI and the 2013 ED, not allowing a revaluation model for property, plant and equipment appears to be the single biggest impediment to adoption of the *IFRS for SMEs* in some jurisdictions. The IASB also agreed with those respondents who stated that current value information is potentially more useful than historical cost information. The IASB therefore decided that the benefits of a wider use of the *IFRS for SMEs*, and hence the potential for global improvements in reporting and consistency, together with the usefulness of the information provided, outweigh the perceived costs to users and preparers of financial statements of adding this option. Furthermore, the IASB noted that the change introduces only an option, not a requirement. Consequently, it does not necessitate a change or additional costs for preparers. The IASB also noted that there was nothing to prevent authorities and standard-setters in individual jurisdictions from requiring all SMEs in their jurisdiction to use only the cost model or only the revaluation model for property, plant and equipment. Such action would not prevent SMEs from stating compliance with the *IFRS for SMEs*.

BC212 Consistently with full IFRS, the *IFRS for SMEs* does not generally prescribe how, when or if amounts can be transferred between components of equity (see paragraph BC202(a)). Instead, these decisions are left to the discretion of preparers, subject to the constraints imposed by Section 2. Section 2 requires that the information presented must be understandable, relevant and reliable. The IASB noted that, in certain circumstances, it may be appropriate to transfer all or some of the accumulated other comprehensive income from the revaluation surplus for property, plant and equipment directly to retained income or another component of equity. The IASB also noted that in other circumstances, such transfers may be mandated or prohibited by local legislation. Consequently, consistently with the requirements for other elements of accumulated other comprehensive income, when adding an option to use the revaluation model for property, plant and equipment, the IASB decided not to prescribe how, when or if items of accumulated other comprehensive income should be transferred to other components of equity.

Capitalisation of development or borrowing costs

BC213 Only a small number of respondents to the RFI and the 2013 ED supported a requirement for SMEs to capitalise development and/or borrowing costs based on similar criteria to full IFRS. However, several respondents supported giving SMEs an option to capitalise development and borrowing costs based on similar criteria to full IFRS. They supported introducing this option for reasons similar to those expressed by respondents in paragraph BC210, ie the effect on current and future borrowing arrangements and high-inflation environments. However, many respondents did not support changing the current requirements and would continue to require SMEs to expense all development and borrowing costs.

BC214 The *IFRS for SMEs* requires all borrowing and development costs to be recognised as expenses. Full IFRS requires the capitalisation of borrowing and development costs meeting certain criteria; otherwise they are recognised as expenses. Consequently, the *IFRS for SMEs* simplifies the requirements in full IFRS, instead of removing an option permitted in full IFRS. The IASB therefore noted that allowing options to capitalise certain development and borrowing costs would involve different considerations than allowing a revaluation option for property, plant and equipment. In particular the IASB observed that permitting accounting policy options to capitalise development and borrowing costs that meet the criteria for capitalisation in IAS 38/IAS 23, in addition to the current approach, would result in more accounting policy options than full IFRS. The IASB noted that it continues to support its rationale for requiring the recognition of all development and borrowing costs as expenses, for cost-benefit reasons as set out in paragraphs BC113–BC114 and BC120, and for not providing the additional, more complex, accounting policy options for SMEs as set out in paragraphs BC208–BC209. The IASB noted that an SME should disclose additional information about its borrowing or development costs if it is considered relevant to users of its financial statements.

Optional fallback to full IFRS for financial instruments

BC215 The *IFRS for SMEs* permits entities to choose to apply either (see paragraph 11.2 of the *IFRS for SMEs*):

(a) the provisions of both Sections 11 and 12 in full; or

(b) the recognition and measurement provisions of IAS 39 and the disclosure requirements of Sections 11 and 12.

The *IFRS for SMEs* refers specifically to IAS 39. SMEs are not permitted to apply IFRS 9 *Financial Instruments*.

BC216 Paragraphs BC187–BC196 explain the IASB's principles for dealing with new and revised full IFRS Standards. In line with those principles, the IASB decided that IFRS 9 should not be considered when developing the 2013 ED because, at that time, it had not yet been completed. In addition, the IASB's reasoning for not considering changes to full IFRS after the 2013 ED had been issued is set out in paragraphs BC206–BC207. The IASB noted that

its reasoning for not considering IFRS 10, IFRS 11, IFRS 12 *Disclosure of the Interests in Other Entities* and IFRS 13 during this review (see paragraph BC198) is equally applicable to IFRS 9.

BC217 Consistently with the primary aim of developing a stand-alone, simplified set of accounting principles for SMEs, the IASB would prefer the fallback to full IFRS to be ultimately removed. However, the IASB decided that the fallback to IAS 39 should be retained until IFRS 9 is considered at a future review for the following reasons:

(a) when the *IFRS for SMEs* was issued, the IASB decided that SMEs should be permitted to have the same accounting policy options as in IAS 39 pending completion of the IASB's *Financial Instruments* project and this reasoning remains valid until IFRS 9 is considered (see paragraph BC106).

(b) if entities are currently applying IAS 39, the IASB does not think that it is appropriate to require them to change to Sections 11 and 12 when it is expected that IFRS 9 will be considered at the next review of the *IFRS for SMEs*.

(c) the IASB notes that, based on its outreach, most SMEs, except subsidiaries of full IFRS groups, appear to have found the fallback to full IFRS onerous and have chosen to follow Sections 11 and 12 in full. However, without sufficient evidence, the IASB does not think that the fallback to full IFRS should be removed during this comprehensive review.

The IASB discussed introducing a fallback to IFRS 9 as a further (third) option. This was rejected because the IASB considered that the potential confusion created by having three alternative models outweighed any potential benefits.

BC218 The IASB noted that an SME that elects to follow the recognition and measurement principles of IAS 39, instead of those in Sections 11 and 12, would currently apply the version of IAS 39 in the full IFRS publication titled *International Financial Reporting Standards IFRS® Consolidated without early application* (Blue Book) that is in effect at the entity's reporting date (ie without early application of parts of IFRS 9). The IASB also observed that when IAS 39 is superseded by IFRS 9, a copy of the version of IAS 39 that applied immediately prior to IFRS 9 will need to be retained for reference on the SME webpages of the IASB's website while the fallback to IAS 39 remains.

Accounting for income tax

BC219 When the *IFRS for SMEs* was issued in 2009, Section 29 was based on the IASB's Exposure Draft *Income Tax* (the '2009 IAS 12 ED'), which was published in March 2009. However, the changes proposed in the 2009 IAS 12 ED were never finalised by the IASB. Consequently, the IASB decided to align the main requirements for recognising and measuring deferred tax in Section 29 with the approach in IAS 12, modified to be consistent with the other requirements of the *IFRS for SMEs*. The IASB noted that most of the respondents to the RFI supported this approach. The IASB also observed that in many jurisdictions IAS 12 has been applied by entities, including SMEs, for years. Aligning the requirements with IAS 12 would have the advantage of enabling SMEs to draw on this experience, as well as the education material available on IAS 12, to understand the requirements. The IASB continues to support its reasoning as set out in paragraph BC145 for not permitting the taxes payable approach. However, while believing that the principle of recognising deferred tax assets and liabilities is appropriate for SMEs, the IASB asked a question in the 2013 ED seeking feedback on whether Section 29 (revised) in the 2013 ED would be operational for SMEs, or whether further simplifications or guidance should be considered.

BC220 Some of the respondents to the 2013 ED supported having an undue cost or effort exemption for some or all of the requirements of Section 29 (revised). However, those respondents who suggested having an undue cost or effort exemption for some requirements of Section 29 (revised) did not identify which requirements should qualify for exemption. Furthermore, the only simplified fallback solution suggested that could be applied if an undue cost or effort exemption was used was the taxes payable approach with disclosures. The IASB decided not to consider such an exemption because it thinks that most SMEs will have

similar types of transactions year on year. The IASB noted that once those SMEs understand the deferred tax computations for those transactions, the accounting treatment should be relatively straightforward from then on.

BC221 Some respondents supported including additional material from IAS 12. In response to some of the concerns raised, the IASB decided to add paragraph 29.21(c) to the *IFRS for SMEs* and modify paragraphs 29.30 and 29.40(c).

BC222 The IASB decided to keep the simplified presentation requirements in the existing Section 29 with one further simplification. The IASB noted that IAS 12 has separate requirements for offsetting deferred tax assets and liabilities to avoid the need for detailed scheduling, whereas under Section 29 the requirements for offsetting deferred tax assets and liabilities are the same as for offsetting current tax assets and liabilities. The IASB therefore decided to add an undue cost or effort exemption so that offsetting income tax assets and liabilities would not be required if significant, detailed scheduling is required. The exemption is intended to provide similar relief to IAS 12 without including the more complex wording used in IAS 12. In response to concerns that the exemption proposed in the 2013 ED was unclear, the IASB clarified the wording in the final amendments.

BC223 The IASB also decided to keep the same level of disclosures as in the existing Section 29. The existing disclosures were reduced and simplified from the 2009 IAS 12 ED on the basis of user needs and cost-benefits. However, because of the amendments to align the recognition and measurement requirements with IAS 12, the IASB has made a number of consequential amendments to the disclosures.

Exploration for and evaluation of mineral resources

BC224 The 2013 ED proposed to describe more clearly the accounting requirements for entities involved in the exploration for, or evaluation of, mineral resources in response to requests by respondents to the RFI. However, some respondents to the 2013 ED asserted that the proposed requirements were more onerous than the related requirements in full IFRS. These respondents noted that paragraph 7 of IFRS 6 exempts an entity under full IFRS from paragraphs 11–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing accounting policies for the recognition and measurement of exploration and evaluation assets. These respondents observed that paragraph 34.11 of the 2013 ED would require an entity to determine an accounting policy in accordance with the accounting policy hierarchy in paragraphs 10.4–10.6 of the *IFRS for SMEs*, which would require an entity to consider the concepts and principles in Section 2. Respondents suggested providing a similar exemption to that in full IFRS in paragraph 34.11. In addition, a few respondents also said that specific guidance should be provided for the accounting for impairment of exploration and evaluation assets, instead of requiring entities to follow the general requirements in Section 27 *Impairment of Assets*. Those respondents asserted that developing specific guidance for the impairment of exploration and evaluation assets was an important issue in IFRS 6.

BC225 Some respondents said that permitting a fallback to IFRS 6 would be a good solution to address those concerns. However, the IASB noted that the *IFRS for SMEs* is intended to be a stand-alone IFRS and so it did not support introducing another fallback to full IFRS (see paragraph BC217). Consequently, the IASB decided to add requirements in Section 34 that align the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6. The IASB noted that this would ensure that the *IFRS for SMEs* provides the same relief as full IFRS for these activities. The IASB thinks that this is important for the reasons set out in paragraphs BC2–BC5 of IFRS 6. The IASB noted that these changes are consistent with maintaining stability during the early years of implementing the *IFRS for SMEs*, because they only affect SMEs with one specific type of activity and they respond to a need for clarity and constitute a simplification for those entities, particularly those making the transition to the *IFRS for SMEs*.

BC226 However, the IASB decided not to make any changes to the presentation and disclosure requirements. It noted that it is not possible for the *IFRS for SMEs* to include industry-specific disclosures for different industries and remain user-friendly for simple SMEs. Nevertheless, it

noted that when additional disclosures are important to an understanding of specific industry activities, paragraph 8.2(c) of the *IFRS for SMEs* would apply.

SMEIG Q&As

BC227 The IASB decided that existing Q&As should be incorporated into the *IFRS for SMEs* and/or the IFRS Foundation's educational material and the original Q&As should then be deleted. The IASB decided that the following guidance from the Q&As should be incorporated into the *IFRS for SMEs*:

(a) clarification of the use of the *IFRS for SMEs* in the parent's separate financial statements in Section 1 (taken from Q&A 2011/01);

(b) clarifying guidance on the undue cost or effort exemption that is used in several sections of the *IFRS for SMEs* (taken from Q&A 2012/01); and

(c) clarification in paragraph 9.18 of the *IFRS for SMEs* that cumulative exchange differences that arise from the translation of a foreign subsidiary are not recognised in profit or loss on the disposal of the subsidiary (taken from Q&A 2012/04).

BC228 The IASB agrees with the SMEIG guidance in paragraph BC227(a)–(c) and also the SMEIG's reasoning that supports the guidance as set out in the SMEIG Q&As. The IASB has provided additional reasoning for paragraph BC227(b)–(c) in paragraphs BC231–BC235. The IASB decided that the remaining guidance in the SMEIG Q&As was more educational in nature and so decided that it should only be provided as part of the IFRS Foundation's educational material.

BC229 The result of incorporating any non-mandatory guidance from the Q&As in the *IFRS for SMEs* is that it will become mandatory. Only the parts of the Q&As incorporated in the *IFRS for SMEs* will become mandatory, and not the full Q&As from which the guidance was taken.

BC230 The IASB decided to delete all of the existing SMEIG Q&As at the time of issuing the amendments to the *IFRS for SMEs*. The guidance in the Q&As has been incorporated into the IFRS Foundation's educational material that is available on the IASB website: http://go.ifrs.org/smetraining. Consequently, the guidance from the Q&As will continue to be available on the IASB website.

Undue cost or effort

BC231 Paragraphs 2.13 and 2.14 of the *IFRS for SMEs* highlight the balance between benefits and costs, and state the general principle to which the IASB refers in making its standard-setting decisions. The requirements within the *IFRS for SMEs* have been developed by taking into consideration the balance between benefits and costs. In addition to this consideration, the *IFRS for SMEs* also allows an undue cost or effort exemption in certain specific and defined circumstances. The IASB noted that some interested parties appear to have misunderstood the undue cost or effort exemption, and that these interested parties have concluded that it is a general principle/exemption that can be applied throughout the *IFRS for SMEs*. Consequently, the IASB decided that including additional guidance on applying the undue cost or effort exemptions will help to eliminate this misconception.

BC232 The IASB also thinks that the clarifying guidance will help to emphasise two further points:

(a) that the undue cost or effort exemption is not intended to be a low hurdle. This is because an entity is required to carefully weigh the expected effects of applying the exemption on the users of the financial statements against the cost or effort of complying with the related requirement. In particular, the IASB observed that it would expect that if an entity already had, or could easily and inexpensively acquire, the information necessary to comply with a requirement, any related undue cost or effort exemption would not be applicable. This is because, in that case, the benefits to the users of the financial statements of having the information would be expected to exceed any further cost or effort by the entity.

(b) that an entity must make a new assessment of whether a requirement will involve undue cost or effort at each reporting date.

BC233 Some respondents to the 2013 ED asked for further guidance and/or a definition of undue cost or effort. The IASB decided that it was not appropriate to provide further guidance in the *IFRS for SMEs* because, ultimately, application of an undue cost or effort exemption depends on an SME's specific circumstances and on management's judgement. The IASB also noted that the terms 'undue cost' and 'undue cost or effort' are used in full IFRS and it would not be appropriate to define a term under the *IFRS for SMEs* that is used, but not defined, in full IFRS. This is because it may be used to interpret requirements in full IFRS. The IASB also observed that the application of an undue cost or effort exemption necessitates consideration of how those that are expected to use the financial statements would be affected if that exemption is taken. Consequently, undue cost or effort would generally be easier to meet for SMEs than for entities with public accountability, because the notion is applied relative to the benefits to users and SMEs are not accountable to public stakeholders.

Exchange differences on the translation of a foreign subsidiary

BC234 Some respondents to the 2013 ED said cumulative exchange differences from the translation of a foreign subsidiary should be recognised in profit or loss on disposal of a subsidiary, which would be consistent with full IFRS. The IASB noted that not requiring 'recycling' through profit and loss was a change specifically made during the IASB's redeliberations in response to comments on the 2007 Exposure Draft (see paragraph BC34(ee)). Some of the respondents to the 2013 ED also noted that if there is no requirement to recycle the exchange differences to profit or loss on disposal of a subsidiary, an SME should be permitted to recognise those exchange differences in retained earnings either immediately or on disposal; otherwise they will remain as a separate component of equity forever. The IASB noted that the *IFRS for SMEs* does not contain any requirements that prohibit SMEs from transferring amounts recognised in other comprehensive income within equity. Consequently, an SME could, in accordance with the *IFRS for SMEs*, transfer any cumulative exchange differences recognised in other comprehensive income and shown as a separate component of equity (for example, in a foreign currency translations reserve) directly into retained earnings on disposal of the related subsidiary (see paragraph BC202(a)). Nevertheless, the IASB observed that an entity would also need to consider whether there were jurisdiction-specific restrictions on transfers between components of equity.

The amendments to the *IFRS for SMEs* as a result of the initial comprehensive review

BC235 The IASB made 56 changes to the *IFRS for SMEs* during the initial comprehensive review. They are of the following types:

(a) three significant changes;

(b) twelve relatively minor changes/clarifications based on new and revised full IFRS Standards;

(c) seven new exemptions from the requirements in the *IFRS for SMEs* that are permitted only in special cases;

(d) six other changes to the recognition and measurement requirements;

(e) six other changes to the presentation and measurement requirements; and

(f) minor clarifications or clarifying guidance that are not expected to change current practice.

Significant changes to the *IFRS for SMEs*

BC236 The IASB made three significant changes during the initial comprehensive review:

(a) addition of an option to use the revaluation model for property, plant and equipment (see paragraphs BC208–BC212);

(b) alignment of the main recognition and measurement requirements for deferred income tax with IAS 12 (see paragraphs BC219–BC223); and

(c) alignment of the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6 (see paragraph BC224–BC226).

Other changes to the *IFRS for SMEs*

New and revised full IFRS Standards

BC237 The IASB made twelve relatively minor changes/clarifications based on new and revised full IFRS Standards during the initial comprehensive review (see paragraphs BC201–BC207).

New exemptions

BC238 The IASB added seven new exemptions during the initial comprehensive review that are permitted in special cases:

(a) four undue cost or effort exemptions (see paragraphs BC239–BC241).

(b) two exemptions for common control transactions (see paragraph BC242–BC243).

(c) the exemption in paragraph 70 of IAS 16 that an entity may use the cost of the replacement part as an indication of what the cost of the replaced part was at the time that it was acquired or constructed, if it is not practicable to determine the carrying amount of the latter. This exemption was added in response to concerns raised on the 2013 ED that the *IFRS for SMEs* should not be more onerous than full IFRS.

Undue cost or effort exemptions

BC239 The IASB decided to add undue cost or effort exemptions for the following requirements in the *IFRS for SMEs* in response to comments raised by respondents to the RFI and the 2013 ED:

(a) measurement of investments in equity instruments at fair value in Sections 11 and 12;

(b) recognising intangible assets of the acquiree separately in a business combination;

(c) the requirement to measure the liability to pay a non-cash distribution at the fair value of the non-cash assets to be distributed; and

(d) the requirement to offset income tax assets and liabilities (see paragraph BC222).

BC240 The IASB noted that the requirements in paragraph BC239(a)–(c) are often very difficult for SMEs to apply in the absence of market data, because they involve substantial judgement and complex calculations. The IASB therefore decided that, in these three situations, the benefits of having the information to users of SME financial statements do not justify SMEs spending undue cost or effort to provide the necessary fair value information. Nevertheless, the IASB also noted that an undue cost or effort exemption is not intended to be a low hurdle and that the additional guidance on application of the exemption will help to clarify this (see paragraphs BC231–BC233).

BC241 Some respondents to the 2013 ED noted that the identification of contingent liabilities in a business combination is also challenging and said that the exemption should be extended to contingent liabilities. The IASB decided not to extend the exemption. The IASB noted that one of the reasons that the IASB permitted an undue cost or effort exemption for intangible assets acquired in a business combination is because the outcome of not separately recognising those intangible assets is unlikely to have a significant impact on an SME's profit or loss or financial position. This is because any intangible assets that are not separately recognised will be included in the amount recognised as goodwill, and the resulting accounting will be similar because many SMEs will be required to amortise goodwill and other intangibles over a period of 10 years or less (see paragraph BC247). This reason does not apply to contingent liabilities assumed in a business combination.

Common control exemptions

BC242 In response to the concerns raised by respondents to the RFI, the IASB decided to add exemptions for the following transactions:

(a) paragraph 22.8 of the *IFRS for SMEs*—exemption from determination of the value of equity issued as the fair value of cash or other resources received or receivable for equity instruments issued as part of a business combination under common control. The IASB further decided that the exemption added to paragraph 22.8 should cover equity instruments issued as part of a business combination (including business combinations under common control), because paragraph 19.11 provides specific guidance for the accounting for equity instruments that are issued as part of a business combination within the scope of Section 19 *Business Combinations and Goodwill.*

(b) paragraph 22.18B of the *IFRS for SMEs*—exemption for distributions of non-cash assets that are ultimately controlled by the same parties before and after distribution in line with full IFRS. The IASB noted that paragraph 22.18 was added to the *IFRS for SMEs* to incorporate the conclusions in IFRIC 17. The IASB agrees that it was an oversight not to include the scope exclusion in paragraph 5 of IFRIC 17.

BC243 The IASB noted that paragraph 10.4 of the accounting policy hierarchy in the *IFRS for SMEs* states that if the *IFRS for SMEs* does not specifically address a transaction, an entity's management uses its judgement in developing an accounting policy. Paragraph 10.5 states that the entity considers other guidance in the *IFRS for SMEs* dealing with similar and related issues. Consequently, the IASB observed that by not providing specific requirements for equity instruments issued as part of a business combination of entities or businesses under common control, SMEs would still be able to apply paragraphs 19.11 or 22.8 by analogy. Similarly, SMEs would be permitted to apply paragraph 22.18 by analogy to distributions of non-cash assets that are ultimately controlled by the same parties before and after distribution. However, SMEs would also be able to consider other accounting treatments for those transactions, provided that the accounting treatments chosen are applied consistently and comply with the accounting policy hierarchy in paragraphs 10.4–10.5. The IASB also observed that this would be the case for the types of transactions covered by the exemptions in paragraph 22.15C(a)–(b).

Other changes to the recognition and measurement requirements

BC244 The IASB made the following six additional changes to the recognition and measurement requirement in the *IFRS for SMEs* during the initial comprehensive review. The IASB observed that four of those changes (see paragraphs BC245 and BC248–BC250) are unlikely to affect the vast majority of SMEs.

Combined financial statements

BC245 The IASB decided to amend the definition of combined financial statements to refer to entities under common control, instead of only those under common control by a single investor (see paragraph 9.28 of the *IFRS for SMEs*). This is because the IASB observed that combined financial statements may be prepared for entities controlled by a group of investors, such as a family.

Basic financial instruments

BC246 The 2013 ED proposed to clarify that foreign currency loans and loans with standard loan covenants will usually be basic financial instruments, after considering concerns from respondents to the RFI that these instruments do not meet the current criteria in paragraph 11.9 of the *IFRS for SMEs*. However, some respondents to the 2013 ED raised concerns that, even given the proposed changes to paragraph 11.9, certain 'basic' debt instruments, such as loans with stepped interest rates and early repayment penalties, would not meet the criteria in paragraph 11.9. They noted that this would mean that such debt instruments would be required to be measured at fair value in accordance with Section 12. Some respondents also said that paragraph 11.9 was difficult to understand and that the IASB should try to simplify the wording. The IASB concluded that many of the debt instruments about which the respondents had concerns would actually meet the criteria in paragraph 11.9. Consequently, the IASB reaffirmed that the criteria in paragraph 11.9 should result in amortised cost measurement for most simple loans taken out by SMEs. The IASB also decided to add illustrative examples to help SMEs apply paragraph 11.9. These examples address some of the specific debt instruments about which the respondents had concerns and that the IASB also thinks are likely to be commonly entered into by SMEs.

Useful life of intangible assets

BC247 The IASB decided to require that if the useful life of goodwill or another intangible asset cannot be established reliably then the useful life shall be estimated by management, but shall not exceed 10 years. Previously, the *IFRS for SMEs* required that if a reliable estimate could not be made, the useful life would be presumed to be 10 years. The IASB noted that although a default useful life of 10 years is simple, it does not provide users of financial statements with any information about the period over which goodwill or another intangible asset is expected to be available for use. The IASB also noted that requiring management to make a best estimate is unlikely to require additional work, because paragraphs 18.20 and 19.23 of the *IFRS for SMEs* already require management to assess whether the useful life can be established reliably. Some respondents to the 2013 ED expressed concern about requiring management to estimate the useful life if the useful life cannot be established reliably. The IASB noted that SMEs are required to make best estimates in other sections of the *IFRS for SMEs*. Consequently, the IASB confirmed its decision to modify the requirements in the *IFRS for SMEs*.

Leases with an interest rate variation clause linked to market interest rates

BC248 The IASB decided that a lease with an interest rate variation clause linked to market interest rates should be included in Section 20 instead of being accounted for at fair value through profit or loss under Section 12. The IASB noted that such clauses are occasionally found in leases entered into by SMEs. Furthermore, the IASB noted that such an embedded risk would not normally require separate accounting under full IFRS.

Compound financial instruments

BC249 Paragraph 22.15 of the *IFRS for SMEs* required the liability component of a compound financial instrument to be accounted for at amortised cost even if the liability component, had it been a stand-alone instrument, would have been accounted for at fair value through profit or loss under Section 12. The IASB decided to remove this inconsistency and require the liability component to be accounted for in the same way as a similar stand-alone financial liability.

Scope of Section 26

BC250 Paragraph 26.17 of the *IFRS for SMEs* deals with the scenario in which the identifiable consideration received by an entity appears to be less than the fair value of the equity instruments granted or the liability incurred. However, the IASB observed that it only addressed government-mandated plans. The IASB noted that in some jurisdictions the issue arises in instances that are not restricted to government mandated plans. Consequently, the IASB decided to modify paragraph 26.17 to require the guidance to be applied to all share-based payment transactions in which the identifiable consideration appears to be less than the fair value of the equity instruments granted or the liability incurred, and not only to share-based payment transactions provided in accordance with programmes established under law.

Changes to the presentation and disclosure requirements

BC251 The IASB made the following six changes to the presentation and disclosure requirements during the initial comprehensive review:

(a) addition of a requirement that an entity must disclose its reasoning for using an undue cost or effort exemption (see paragraph BC252).

(b) addition of a requirement to present investment property measured at cost less accumulated depreciation and impairment separately on the face of the statement of financial position. The IASB decided to add this line item for consistency with the requirement for biological assets, and because it noted that it was important that investment property measured under the cost model in Section 17 is presented separately from property, plant and equipment.

(c) removal of the requirement to prepare prior year reconciliations of balances for both biological assets and share capital for consistency with other sections of the *IFRS for SMEs*.

(d) removal of the requirement to disclose the accounting policy for termination benefits (see paragraph BC253).

(e) alignment of the definition of ‘related party’ with IAS 24 (2009). The IASB agreed with respondents to the RFI who suggested aligning the definition of a related party with IAS 24 (2009), because the undefined term ‘significant voting power’ was causing problems in practice. The IASB also added a definition of ‘close members of the family of a person’.

BC252 In the 2013 ED the IASB proposed to add clarifying guidance on the application of an undue cost or effort exemption (see paragraphs BC231–BC233). However, the IASB did not propose that an SME should be required to disclose the reasoning for using the exemption. This is because the IASB thought that disclosing the reasoning may be too limited to provide useful information to users of financial statements. However, some respondents to the 2013 ED asserted that disclosure would help to control the use of the exemption and may provide useful information for users of the financial statements at little cost to SMEs. The IASB agreed with this reasoning and decided to require SMEs to disclose their reasoning each time an undue cost or effort exemption was used, with one exception. The IASB decided that a requirement to disclose a qualitative description of the factors that make up any goodwill recognised in a business combination would provide more useful information than the

disclosure of the reasons for using the undue cost or effort exemption to support the non-recognition of certain intangible assets if their fair value could not be measured reliably.

BC253 Some respondents to the 2013 ED disagreed with removing the accounting policy disclosure requirement for termination benefits, solely because entities do not have a choice of accounting treatment for termination benefits. These respondents said that an entity should disclose all accounting policies for which disclosure is relevant to an understanding of the financial statements. The IASB agreed with this reasoning but noted that removing the requirement would be consistent with the disclosure requirements in other sections. The *IFRS for SMEs* has specific disclosure requirements for accounting policies when a choice of models or methods is permitted because, when the related transactions are material, this would normally mean that the disclosure of the accounting policy applied is important in understanding the financial statements. The IASB thinks that when a choice of accounting policy is not available, the general requirement in paragraph 8.5 of the *IFRS for SMEs* to disclose '… accounting policies used that are relevant to an understanding of the financial statements' is sufficient.

BC254 Some respondents to the RFI and the 2013 ED said that the IASB should consider further ways to reduce the disclosure requirements in the *IFRS for SMEs*, but few examples were provided of when the existing disclosures are excessive. In addition, some respondents requested additional disclosure requirements in some areas of the *IFRS for SMEs*. The IASB considered any specific suggestions made but, except as specified in paragraph BC251, did not think that additional changes were necessary. The IASB noted that it is currently looking at ways of improving disclosure under full IFRS and it will consider the outcome of this work at the next review of the *IFRS for SMEs*. The IASB also noted that paragraph 8.2(c) of the *IFRS for SMEs* contains a general requirement that entities must provide additional information if that information is relevant to an understanding of the financial statements.

Minor clarifications of existing requirements in the *IFRS for SMEs*

BC255 The IASB decided to make the following minor amendments to the *IFRS for SMEs* in response to concerns that had been highlighted by interested parties either formally or informally during the initial comprehensive review. The IASB thinks that such amendments clarify existing requirements and would result in a better understanding and application of those requirements. The IASB also observed that because these amendments clarify existing requirements, in most cases they would not be expected to affect the current accounting for affected transactions:

(a) clarification that the entities listed in paragraph 1.3(b) are not automatically publicly accountable (see paragraph 1.3(b) of the *IFRS for SMEs*).

(b) addition of clarifying guidance on the use of the *IFRS for SMEs* in the parent's separate financial statements—based on Q&A 2011/01 (see paragraph 1.7 of the *IFRS for SMEs*).

(c) addition of clarifying guidance on the undue cost or effort exemption that is used in several sections of the *IFRS for SMEs*—based on Q&A 2012/01 (see paragraphs 2.14A–2.14D of the *IFRS for SMEs*).

The IASB's additional reasoning is covered in paragraphs BC231–BC233.

(d) clarification that the single amount presented for discontinued operations includes any impairment of the discontinued operation measured in accordance with Section 27 (see paragraph 5.5(e)(ii) of the *IFRS for SMEs*). The wording previously referred to 'the measurement to fair value less costs to sell'.

The IASB noted that Section 27 requires measurement at the lower of cost and the recoverable amount, not the lower of cost and fair value less costs to sell. However, the IASB does not expect the amendment to have a material impact on SMEs because, when an entity expects to recover the carrying amount of the net assets of a discontinued operation through sale, and the future cash flows from the remaining use of the discontinued operation are estimated to be negligible, the value in use

would approximate fair value less costs to sell (and therefore fair value less costs to sell would approximate the recoverable amount).

(e) clarification that all subsidiaries acquired with the intention of sale or disposal within one year shall be excluded from consolidation and clarifying guidance on how to account for and disclose those subsidiaries (see paragraphs 9.3–9.3C and 9.23A of the *IFRS for SMEs*).

In response to concerns raised by respondents, the IASB has expanded on the guidance previously proposed in the 2013 ED.

(f) addition of clarifying guidance on the preparation of consolidated financial statements if group entities have different reporting dates (see paragraph 9.16 of the *IFRS for SMEs*).

Some respondents to the 2013 ED said that this guidance, which permits a parent entity to use the subsidiary's most recent financial statements, allows too much flexibility. These respondents generally thought that the IASB should also add the requirement in IFRS 10 that the difference between the reporting date of the subsidiary and the parent should be no more than three months and should be consistent for each period. The IASB decided not to add this requirement for SMEs. This is because it noted that, in the rare case in which it would be impracticable to prepare financial statements at the same date, paragraph 9.16 would require the subsidiary's financial statements to be adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. The IASB noted that the removal of the three-month restriction was also a change specifically made during the IASB's redeliberations in response to comments on the 2007 Exposure Draft (see paragraph BC34(l)).

(g) clarification that cumulative exchange differences that arise from the translation of a foreign subsidiary are not recognised in profit or loss on the disposal of the subsidiary—based on Q&A 2012/04 (see paragraph 9.18 of the *IFRS for SMEs*).

(h) clarification of the definition of separate financial statements (see paragraphs 9.24–9.25 and the related definition in the glossary).

(i) clarification of the interaction of the scope of Sections 11 and 12 with other sections of the *IFRS for SMEs* (see paragraphs 11.7 and 12.3 of the *IFRS for SMEs*).

(j) clarification of when an arrangement would constitute a 'financing transaction' (see paragraph 11.13 of the *IFRS for SMEs*).

Some respondents to the 2013 ED asserted that some SMEs are interpreting paragraph 11.13 as requiring them to use the price of the transaction, for example, the nominal value of a loan, instead of the present value of the future payments, for off-market interest-based arrangements with related parties, for example, loans made to employees at less than market rates. Consequently, the IASB decided to clarify that when applying paragraph 11.13, the entity must consider whether an arrangement constitutes a financing transaction for the purposes of the *IFRS for SMEs* for either itself or the counterparty. In other words the entity must consider both financial assets and financial liabilities.

(k) clarification in the guidance on fair value measurement in Section 11 of when the best evidence of fair value may be a price in a binding sale agreement. The guidance applies to fair value measurements in other sections and not just financial instruments within the scope of Section 11 (see paragraph 11.27 of the *IFRS for SMEs*).

In response to concerns raised by respondents, the IASB expanded on the wording previously proposed in the 2013 ED.

(l) clarification of the requirements for hedge accounting, including the addition of a sentence that clarifies the treatment for exchange differences relating to a net investment in a foreign operation for consistency with paragraphs 9.18 and 30.13 (see paragraphs 12.8, 12.23, 12.25 and 12.29 of the *IFRS for SMEs*).

(m) replacement of the undefined term ‘date of exchange’ with ‘date of acquisition’ in the requirements on measuring the cost of a business combination (see paragraph 19.11(a) of the *IFRS for SMEs*).

(n) addition of clarifying guidance on the measurement requirements for employee benefit arrangements, deferred tax and non-controlling interests when allocating the cost of a business combination (see paragraph 19.14 of the *IFRS for SMEs*).

The IASB noted that employee benefit arrangements and deferred tax are the only two areas in which measurement exemptions are necessary under paragraph 19.14 when allocating the cost of a business combination and that SMEs should not assume that they can treat other measures as fair value for other items.

(o) clarification that only some outsourcing arrangements, telecommunication contracts that provide the rights to capacity and take-or-pay contracts are, in substance, leases (see paragraph 20.3 of the *IFRS for SMEs*).

(p) addition of clarifying guidance on classifying financial instruments as equity or a liability (see paragraph 22.3A of the *IFRS for SMEs*).

(q) addition of clarifying guidance on the accounting for the settlement of the dividend payable for a distribution of non-cash assets (see paragraph 22.18 of the *IFRS for SMEs*).

(r) alignment of the scope and the definitions of Section 26 with IFRS 2 to clarify that share-based payment transactions involving equity instruments of other group entities are within the scope of Section 26 (see paragraphs 26.1–26.1A and the related definitions in the glossary of the *IFRS for SMEs*).

Interested parties have told the IASB that it is not clear that the *IFRS for SMEs* applies to equity instruments of other group entities even though paragraph 26.16 addresses group plans. The IASB noted that the *IFRS for SMEs* was finalised at a similar time to the 2009 amendments to IFRS 2 that clarified the scope of IFRS 2 in relation to group plans. Consequently, the 2009 amendments to IFRS 2 were not available during the drafting of the *IFRS for SMEs*. However, to address the concerns raised by interested parties, the IASB decided to align the scope and definitions of Section 26 with IFRS 2 (after the 2009 amendments) to correct possible unintended consequences of the current wording.

(s) clarification of the accounting treatment for vesting conditions and modifications to grants of equity instruments (see paragraphs 26.9, 26.12 and three new definitions in the glossary of the *IFRS for SMEs*).

(t) clarification that the simplification provided for group plans is for the measurement of the share-based payment expense only and does not provide relief from its recognition (see paragraphs 26.16 and 26.22 of the *IFRS for SMEs*).

(u) clarification that Section 27 does not apply to assets arising from construction contracts (see paragraph 27.1(f) of the *IFRS for SMEs*).

(v) clarification of the application of the accounting requirements in paragraph 28.23 to other long-term employee benefits (see paragraph 28.30 of the *IFRS for SMEs*).

(w) clarification that financial instruments that derive their value from the change in a specified foreign exchange rate are excluded from Section 30, but not financial instruments denominated in a foreign currency (see paragraph 30.1 of the *IFRS for SMEs*).

(x) simplification of the wording used in the exemption from the restatement of financial information on the first-time adoption of the *IFRS for SMEs* (see paragraph 35.11 of the *IFRS for SMEs*).

(y) new glossary items for ‘active market’, ‘close members of the family of a person’, ‘foreign operation’, ‘minimum lease payments’ and ‘transaction costs’.

Transition and effective date

Transition provisions

BC256 The IASB does not expect retrospective application of any of the amendments to be significantly burdensome for SMEs. This is because most of the amendments to the *IFRS for SMEs* provide clarification of, or relief from, existing requirements. Consequently, in the 2013 ED the IASB proposed that the amendments to Sections 2–34 in the *IFRS for SMEs* should be applied retrospectively.

BC257 Some respondents to the 2013 ED noted that retrospective application of the amendments to Section 29 could be burdensome, because SMEs will need to consider the effect of each individual change to the requirements for recognising and measuring deferred tax, including minor wording changes. They noted that determining how all these individual changes if applied retrospectively would affect the financial statements could be time-consuming and complex for some SMEs.

BC258 The IASB observed that the amendments to Section 29 are not expected to significantly affect the amounts most SMEs recognise for deferred tax, because the amendments do not change the underlying approach to accounting for deferred tax. Furthermore, the IASB is only making minor changes to the disclosure requirements in Section 29. Consequently, the IASB noted that it would expect the impact of the amendments to Section 29 on the information in the financial statements to be limited for most SMEs. Nevertheless, the IASB does not think that the benefit to users of SME financial statements of restated information under Section 29, which the IASB thinks is only likely to be required in a small percentage of cases, justifies requiring all SMEs to apply Section 29 retrospectively. As a result, the IASB decided allowing SMEs to apply the amendments to Section 29 prospectively from the beginning of the period in which the entity first applies the amendments, because it is supported by cost-benefit reasons.

BC259 The IASB also decided to require prospective application from the beginning of the period in which the entity first applies the amendments for the following two amendments:

(a) the option to use the revaluation model for property, plant and equipment. The IASB observed that such a requirement is consistent with the requirements for a change in accounting policy from the cost model to the revaluation model under full IFRS and that the requirements for SMEs should not be made more onerous than this. The IASB also noted that it may be difficult to apply the revaluation model retrospectively to property, plant and equipment without the use of hindsight in selecting the inputs that would have been appropriate in prior periods.

(b) replacement of the undefined term ‘date of exchange’ with the defined term ‘date of acquisition’. The IASB observed that this would avoid the entity needing to review past business combinations to determine whether these two dates are the same.

BC260 Some respondents also said that some of the other amendments may also be costly to apply retrospectively and they did not think the benefits of restated information would justify incurring significant costs. The IASB observed that Section 35 does not require first-time adopters to retrospectively apply requirements in the *IFRS for SMEs* if it would be impracticable (see paragraph 35.11 of the *IFRS for SMEs*) and including a general ‘impracticable’ exemption in the transition requirements would be consistent with this. Consequently, the IASB decided that, although it does not think that applying the amendments to Sections 2–28 and 30–35 retrospectively would be significantly burdensome for SMEs, it would include an impracticable exemption that would apply to each amendment in isolation in case there are circumstances that it has not considered in which retrospective application would be impracticable.

Effective date of the amendments

BC261 The Preface to the *IFRS for SMEs* states:

> The IASB expects that there will be a period of at least one year between when amendments to the *IFRS for SMEs* are issued and the effective date of those amendments.

BC262 The IASB does not expect any of the amendments to the *IFRS for SMEs* to result in significant changes for SMEs and therefore it decided that the effective date should be set as the first suitable date one year from the date that the amendments are issued. Some respondents said that the implementation time of one year was too short and suggested that a period of 18 months to two years was more appropriate. Some of these respondents noted that SMEs need sufficient time to make the transition to any new requirements because of resource constraints. Some respondents also noted that additional time is required for jurisdictions that have to comply with local endorsement processes to provide sufficient implementation lead time to their SMEs. The IASB observed that the amendments are being issued in May 2015 and therefore the effective date of 1 January 2017 would fall more than 18 months after issue. Consequently, the IASB decided there was no need to reconsider this date.

Early application

BC263 The IASB decided that early application of the amendments to the *IFRS for SMEs* should be permitted to assist entities and jurisdictions that are currently in the process of adopting, or planning to adopt, the *IFRS for SMEs*. The IASB noted that early application would also permit SMEs to use the revised *IFRS for SMEs* for financial statements prepared for earlier years. For example, some SMEs may not be required to file financial statements or may need a significant length of time in order to file them. Consequently, these SMEs might be preparing financial statements a long time after their reporting date and may want to apply the amendments to earlier years.

The IASB's plan for future reviews of the *IFRS for SMEs*

BC264 Respondents to the 2013 ED were evenly divided on whether the IASB should update the *IFRS for SMEs* approximately once every three years, or if it should follow a longer cycle, with five years being the most common alternative suggestion. The IASB supported the following as a tentative approach for future reviews of the *IFRS for SMEs*:

(a) a comprehensive review of the *IFRS for SMEs* should commence approximately two years after the effective date of the amendments to the *IFRS for SMEs* resulting from a previous comprehensive review. This would allow time for SMEs to apply the amendments, and for interested parties to identify and comment on any implementation issues or unintended consequences that result from those amendments. The IASB observed that it expected that comprehensive reviews would begin with the issuance of an RFI.

(b) between comprehensive reviews, the IASB, with input from the SMEIG, would decide whether there is a need for an interim review to consider any new and revised full IFRS Standards not yet incorporated or any urgent amendments that have been identified.

(c) this process would mean that amendments to the *IFRS for SMEs* would not typically be expected to be more frequent than approximately once every three years to provide SMEs with a stable platform.

Analysis of the likely effects of the amendments

BC265 Before the IASB issues new requirements, or makes amendments to existing IFRSs, it considers the costs and benefits of the new pronouncements. This includes assessing the effects on the costs for both preparers and users of financial statements. The IASB also considers the comparative advantage that preparers have in developing information that would otherwise require users of the financial statements to incur costs to develop. The IASB takes into account the benefits of economic decision-making resulting from improved financial reporting. The IASB gains insight on the likely effects of the proposals for new or revised Standards through its formal exposure of proposals and through its analysis and consultations with interested parties through outreach activities.

BC266 The IASB conducted extensive outreach activities with interested parties during the comprehensive review of the *IFRS for SMEs*. This included issuing two public consultation documents (the RFI and the 2013 ED), additional outreach to providers of finance to SMEs and discussing the main issues at meetings of the IFRS Advisory Council and world standard-setters. In addition, the IASB consulted the SMEIG on its proposed amendments during the development of the 2013 ED and the final amendments. This Effects Analysis is based on the feedback received through this process.

BC267 The evaluation of costs and benefits are necessarily qualitative, instead of quantitative. This is because quantifying costs and, particularly, benefits, is inherently difficult. Although other standard-setters undertake similar types of analyses, there is a lack of sufficiently well-established and reliable techniques for quantifying this analysis. Consequently, the IASB sees this Effects Analysis as being part of an evolving process. In addition, the assessment undertaken is that of the likely effects of the new requirements, because the actual effects will not be known until after the new requirements have been applied. These will be considered at the next review of the *IFRS for SMEs*.

BC268 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing new requirements, and the likely ongoing application costs and benefits of new or revised Standards—the costs and benefits are collectively referred to as 'effects'.

BC269 In evaluating the likely effects of the amendments, the IASB has considered how:

(a) activities would be reported in the financial statements of those applying the *IFRS for SMEs*;

(b) comparability of financial information would be improved both between different reporting periods for the same entity and between different entities in a particular reporting period;

(c) more useful financial reporting would result in better economic decision-making;

(d) the compliance costs for preparers would likely be affected; and

(e) the costs of analysis for users of financial statements would likely be affected.

Changes that could have a significant effect

BC270 The following are the significant amendments to the *IFRS for SMEs*. All of these amendments closely align the related requirements with full IFRS. Consequently, an important benefit of these amendments is closer alignment with full IFRS. The following is a further consideration of the effects of these amendments in the context of SME financial statements:

(a) addition of an option to use the revaluation model.

Users of SME financial statements have told the IASB that they do not like entities to apply different accounting policy options for similar transactions because it affects comparability between entities. Nevertheless, the IASB has received significant feedback from preparers, standard-setters, accounting firms and other interested parties that not having an option to revalue property, plant and equipment is a barrier to the adoption of the *IFRS for SMEs* in jurisdictions in which SMEs

commonly revalue their property, plant and equipment and/or are required by law to revalue property, plant and equipment. In addition, the IASB also agreed with those respondents who stated that current value information is potentially more useful than historical cost information. Consequently, the IASB decided that in this special case, the benefits of a wider use of the *IFRS for SMEs*, and hence the potential for global improvements in reporting and consistency, outweigh the importance to users of SME financial statements of prohibiting this option for property, plant and equipment. Furthermore, the IASB noted that although the additional requirements to incorporate the revaluation option may increase the perceived complexity of the *IFRS for SMEs* slightly, the amendments introduce an option, not a requirement. Consequently, they do not necessitate a change or additional costs for preparers (see also paragraphs BC208–BC212).

(b) alignment of the main recognition and measurement requirements for deferred income tax with IAS 12.

Alignment is expected to have a limited overall effect on the recognition, measurement, presentation and disclosure of deferred tax (see paragraphs BC219–BC223). Consequently, the IASB does not expect the information provided to users of financial statements to be significantly affected. Furthermore, although preparers will initially have to spend time understanding the revised requirements, in most cases this is not expected to cause undue cost or effort—and if it does, the transition provisions provide relief from the retrospective restatement of the amounts for deferred tax. The IASB noted that some SMEs may find the revised requirements in Section 29 easier to apply than the previous requirements, for example, if they are familiar with the accounting for deferred tax under full IFRS or because of the significant training material and expertise in some jurisdictions on application of IAS 12.

(c) alignment of the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6.

The IASB noted that this amendment ensures that the requirements in the *IFRS for SMEs* are not more onerous than full IFRS. These requirements only apply to a specific type of activity and so will not affect most SMEs and users of their financial statements.

Other changes supported by cost-benefits reasons

BC271 The IASB thinks that the following changes are supported by cost-benefit reasons as explained in the paragraphs that are made reference to:

(a) amending paragraph 18.20 of the *IFRS for SMEs* to specify that if the useful life of an intangible asset, including goodwill, cannot be established reliably, the useful life shall be determined based on management's best estimate but shall not exceed 10 years. This replaces the requirement to use a fixed 10-year life in the absence of a reliable estimate of the useful life. Using the best estimate is expected to provide better information for users of financial statements than requiring a fixed 10-year life at no additional cost to preparers (see paragraphs BC247).

(b) the addition of an undue cost or effort exemption for the following five requirements (see paragraphs BC202, BC222 and BC239–BC241):

(i) measurement of investments in equity instruments at fair value in Sections 11 and 12;

(ii) recognising intangible assets separately in a business combination;

(iii) measurement of the entity's own equity instruments at fair value when they are issued to a creditor to extinguish a liability (which results from incorporating the conclusions of IFRIC 19);

(iv) the requirement to measure the liability to pay a non-cash distribution at the fair value of the non-cash assets to be distributed; and

(v) the requirement to offset income tax assets and liabilities.

(c) a requirement that an entity must disclose its reasoning for using any undue cost or effort exemption (see paragraph BC252).

(d) the transition requirements for the amendments to the *IFRS for SMEs* (see paragraphs BC258–BC260).

Changes that are expected to have a limited effect

BC272 Apart from the changes described in paragraphs BC270–BC271, the IASB's amendments to the *IFRS for SMEs* are either one or more of the following types:

(a) relatively minor changes that align the requirements in the *IFRS for SMEs* with full IFRS to incorporate some of the changes in new or revised full IFRS Standards and/or to include clarifying guidance from full IFRS. These changes were introduced to reduce the costs of applying the *IFRS for SMEs* because they either provide additional clarity, a simplification, and/or they fix known or expected problems or the potential for diversity in practice. These changes are not expected to add complexity for SME preparers and are in areas in which the needs of users of SME financial statements are expected to be similar to the needs of users of the financial statements of publicly accountable entities.

(b) changes that clarify existing requirements or remove unintended consequences of the existing wording in the *IFRS for SMEs*. The effect of those amendments is expected to be a better understanding and application of the requirements in the *IFRS for SMEs* and, in most cases, they would not be expected to affect the current accounting for those transactions.

(c) changes that are not expected to have a material impact for the vast majority of SMEs because, for example, they relate to transactions that are only rarely encountered by SMEs.

Dissenting opinions

Dissent of James J Leisenring from the *IFRS for SMEs* issued in July 2009

DO1 Mr Leisenring dissents from the issue of the IFRS because he believes that the *IFRS for SMEs* is neither necessary nor desirable.

DO2 It is unnecessary because the vast majority of accounting policy decisions of SMEs are straightforward and extensive reference to IFRSs will not be required and, when required, not burdensome.

DO3 It is undesirable because the IFRS would produce non-comparable information. SMEs will not be comparable with each other and will not be comparable with publicly accountable entities. That result is inconsistent with the IASB *Framework* and the concepts and pervasive principles of the IFRS.

DO4 Non-comparability will result because the IFRS would allow SMEs, as a result of paragraph 10.5, to ignore the requirements of other IFRSs even when the specific accounting issue is addressed in those IFRSs. If an entity is satisfied with the result of applying paragraph 10.5(a) and (b) there is never a requirement to look to full IFRSs. Thus, identical transactions can be accounted for differently by different SMEs and differently from publicly accountable entities. If the Board finds it necessary to develop educational materials to assist SMEs in applying IFRSs, that would certainly be appropriate. However, Mr Leisenring believes that in all circumstances IFRSs should ultimately be the source of accounting guidance for all entities.

DO5 Mr Leisenring does not believe that the Board has demonstrated the need to make modifications to recognition and measurement requirements in IFRSs for application by SMEs on the basis of either cost-benefit analysis or user needs. As a result, he would not have any differences in recognition and measurement requirements from full IFRSs. Alternatively, he would much more extensively modify the disclosure requirements to meet special user needs. That modification might well create disclosures not required at present, such as information about economic dependency and common control.

DO6 Mr Leisenring also believes that the IFRS is inconsistent with the Constitution of the International Accounting Standards Committee Foundation and the *Preface to International Financial Reporting Standards*. Those documents set out an objective of a single set of accounting standards taking account of the special needs of small and medium-sized entities and emerging economies. Mr Leisenring accepts that objective but does not believe it implies separate sets of standards for entities in differing circumstances as indicated in paragraph BC42. The conclusion of that paragraph suggests that many sets of accounting standards would be appropriate depending on different circumstances.

Dissent of Ms Tokar from 2015 Amendments to the *IFRS for SMEs*

DO1 Ms Tokar is dissenting because of the IASB's decision to make reporting of non-cash distributions at fair value subject to an undue cost or effort exemption. She is concerned that the undue cost or effort relief will deprive financial statement users of relevant information about the value of assets distributed to owners. While she could accept that an undue cost or effort exemption may be appropriate with respect to remeasuring the asset to be distributed between the time of recognition of the distribution payable and the time of settlement, she dissents from providing an undue cost or effort exemption in respect of the initial measurement of the transaction.

DO2 In her view, fair value information should normally be used to assess the merits of the distribution decision from a corporate governance perspective, and thus this information should be available when financial statements are prepared. Although the IASB has sought to clarify, in these amendments, the circumstances in which an undue cost or effort exemption is available, Ms Tokar is concerned that allowing an undue cost or effort exemption for transactions for which fair value information should be available implies a lower hurdle than the IASB intends for the use of such an exemption. She believes that the effectiveness of the *IFRS for SMEs*, which includes a number of undue cost or effort exemptions, requires the exemption to be used only in circumstances in which the costs (both monetary and in entity resources, or 'effort') clearly outweigh the benefits to users of having the information.

Illustrative Financial Statements and
Table of Presentation and Disclosure Requirements

Hong Kong Financial Reporting Standard for Private Entities

This illustrative financial statements and table of presentation and disclosure requirements are based on the relevant documents of International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs), which was published by the International Accounting Standards Board (IASB), and do not contain guidance on the disclosure requirements of the Hong Kong Companies Ordinance.

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

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Illustrative Financial Statements
Table of Presentation and Disclosure Requirements

Hong Kong Financial Reporting Standard for Private Entities (HKFRS for Private Entities) is based on International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). In approving HKFRS for Private Entities, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the Illustrative Financial Statements and Table of Presentation and Disclosure Requirements of International Accounting Standards Board (IASB) on IFRS for SMEs. Accordingly, there are no differences between HKFRS for Private Entities and IFRS for SMEs. The IASB's Illustrative Financial Statements and Table of Presentation and Disclosure Requirements is reproduced below. The paragraph numbers of IFRS for SMEs referred to below generally correspond with those in HKFRS for Private Entities.

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International Financial Reporting Standard for Small and Medium-Sized Entities

Illustrative Financial Statements and Table of Presentation and Disclosure Requirements

This guidance accompanies, but is not part of, the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).

Illustrative financial statements

F1 Section 3 *Financial Statement Presentation* of the *IFRS for SMEs* defines a complete set of financial statements and prescribes general standards of financial statement presentation. Sections 4 *Statement of Financial Position*, Section 5 *Statement of Comprehensive Income and Income Statement, Section 6 Statement of Changes in Equity and Statement of Income and Retained Earnings, Section 7 Statement of Cash Flows and Section 8 Notes to the Financial Statements* prescribe the format and content of the individual financial statements and notes. Other sections of the *IFRS for SMEs* establish additional presentation and disclosure requirements. The following financial statements illustrate how those presentation and disclosure requirements might be met by a typical small or medium-sized entity. Of course, each entity will need to consider the content, sequencing and format of presentation and the descriptions used for line items to achieve a fair presentation in that entity's particular circumstances. These illustrative financial statements should not be regarded as a template appropriate for all entities.

F2 The illustrative statement of financial position presents current assets followed by non-current assets, and presents current liabilities followed by non-current liabilities and then by equity (ie most liquid items first). In some jurisdictions, the sequencing is typically reversed (ie most liquid items last), and that is also permitted by the *IFRS for SMEs*. Consistently with paragraph 3.22 of the *IFRS for SMEs*, an entity may use titles for the financial statements other than those used in these illustrations.

F3 In accordance with paragraph 3.18, the illustrative financial statements present a single statement of comprehensive income and retained earnings in place of two separate statements—a statement of comprehensive income and a statement of changes in equity. This may be done if the only changes to the equity of an entity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy. (Because there are no items of other comprehensive income, this statement could have been titled statement of income and retained earnings.) Two statements of comprehensive income and retained earnings are provided to illustrate the alternative classifications of income and expenses, by nature and by function—see paragraph 5.11 of the *IFRS for SMEs*.

F4 The illustrative financial statements are not intended to illustrate all aspects of the *IFRS for SMEs*. The IFRS Foundation's *IFRS for SMEs* training material, available on the SME webpages of the IFRS Foundation website (www.ifrs.org), contains, by section, further illustrations of the presentation and disclosure requirements of the *IFRS for SMEs*.

F5 The *IFRS for SMEs* does not require a statement of financial position at the beginning of the earliest comparative period. The following illustrative statement of financial position only includes a column for the opening statement of financial position to aid in understanding of the calculations underlying amounts in the statement of cash flows.

XYZ Group

Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 1 – illustrating the classification of expenses by function)

	Notes	20X2	20X1
		CU	CU
Revenue	5	6,863,545	5,808,653
Cost of sales		(5,178,530)	(4,422,575)
Gross profit		1,685,015	1,386,078
Other income	6	88,850	25,000
Distribution costs		(175,550)	(156,800)
Administrative expenses		(810,230)	(660,389)
Other expenses		(106,763)	(100,030)
Finance costs	7	(26,366)	(36,712)
Profit before tax	8	654,956	457,147
Income tax expense	9	(270,250)	(189,559)
Profit for the year		384,706	267,588
Retained earnings at start of year		2,171,353	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,406,059	2,171,353

Note: The format illustrated aggregates expenses according to their function (cost of sales, distribution, administrative etc). As the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a single statement of comprehensive income and retained earnings instead of separate statements of comprehensive income and changes in equity.

XYZ Group

Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 2 – illustrating the classification of expenses by nature)

	Notes	20X2	20X1
		CU	CU
Revenue	5	6,863,545	5,808,653
Other income	6	88,850	25,000
Changes in inventories of finished goods and work in progress		3,310	(1,360)
Raw material and consumables used		(4,786,699)	(4,092,185)
Employee salaries and benefits		(936,142)	(879,900)
Depreciation and amortisation expense		(272,060)	(221,247)
Impairment of property, plant and equipment		(30,000	—
Other expenses		(249,482)	(145,102)
Finance costs	7	(26,366)	(36,712)
Profit before tax	8	654,956	457,147
Income tax expense	9	(270,250)	(189,559)
Profit for the year		384,706	267,588
Retained earnings at start of year		2,171,353	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,406,059	2,171,353

Note: The format illustrated aggregates expenses according to their nature (raw materials and consumables, employee salaries and benefits, depreciation and amortisation, impairment etc). As the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a single statement of comprehensive income and retained earnings instead of separate statements of comprehensive income and changes in equity.

XYZ Group

Consolidated statement of financial position at 31 December 20X2

	Notes	20X2	20X1	20X0
		CU	CU	CU
ASSETS				
Current assets				
Cash		28,700	22,075	18,478
Trade and other receivables	10	585,548	573,862	521,234
Inventories	11	57,381	47,920	45,050
		671,629	643,857	584,762
Non-current assets				
Investment in associate	12	107,500	107,500	107,500
Property, plant and equipment	13	2,549,945	2,401,455	2,186,002
Intangible assets	14	850	2,550	4,250
Deferred tax asset	15	4,309	2,912	2,155
		2,662,604	2,514,417	2,299,907
Total assets		3,334,233	3,158,274	2,884,669
LIABILITIES AND EQUITY				
Current Liabilities				
Bank overdraft	16	83,600	115,507	20,435
Trade payables	17	431,480	420,520	412,690
Interest payable	7	2,000	1,200	—
Current tax liability		271,647	190,316	173,211
Provision for warranty obligations	18	4,200	5,040	2,000
Current portion of employee benefit obligations	19	4,944	4,754	4,571
Current portion of obligations under finance leases	20	21,461	19,884	18,423
		819,332	757,221	631,330

continued …

… continued

XYZ Group

Consolidated statement of financial position at 31 December 20X2

	Notes	20X2	20X1	20X0
		CU	CU	CU
Non-current liabilities				
Bank loan	16	50,000	150,000	150,000
Long-term employee benefit obligations	19	5,679	5,076	5,066
Obligations under finance leases	20	23,163	44,624	64,508
		78,842	199,700	219,574
Total liabilities		898,174	956,921	850,904
Equity				
Share capital	22	30,000	30,000	30,000
Retained earnings	4	2,406,059	2,171,353	2,003,765
		2,436,059	2,201,353	2,033,765
Total liabilities and equity		3,334,233	3,158,274	2,884,669

Note: The *IFRS for SMEs* does not require a statement of financial position at the beginning of the earliest comparative period—hence the shading. It is presented here to aid understanding of the calculations underlying amounts in the statement of cash flows.

XYZ Group
Consolidated statement of cash flows for the year ended 31 December 20X2

	Notes	20X2	20X1
		CU	CU
Cash flows from operating activities			
Profit for the year		384,706	267,588
Adjustments for non-cash income and expenses:			
Non-cash finance costs (a)		800	1,200
Non-cash income tax expense (b)		79,934	16,348
Depreciation of property, plant and equipment		270,360	219,547
Impairment loss		30,000	—
Amortisation of intangibles		1,700	1,700
Cash flow included in investing activities:			
Gain on sale of equipment		(63,850)	—
Changes in operating assets and liabilities			
Decrease (increase) in trade and other receivables		(11,686)	(52,628)
Decrease (increase) in inventories		(9,461)	(2,870)
Increase (decrease) in trade payables (c)		10,120	10,870
Increase in current and long-term employee benefit payable		793	193
Net cash from operating activities		693,416	461,948
Cash flows from Investing activities			
Proceeds from sale of equipment		100,000	—
Purchases of equipment		(485,000)	(435,000)
Net cash used in investing activities		(385,000)	(435,000)
Cash flow from financing activities			
Payment of finance lease liabilities		(19,884)	(18,423)
Repayment of borrowings		(100,000)	—
Dividends paid		(150,000)	(100,000)
Net cash used in financing activities		(269,884)	(118,423)
Net increase (decrease) in cash and cash equivalents		38,532	(91,475)
Cash and cash equivalents at beginning of year		(93,432)	(1,957)
Cash and cash equivalents at end of year	23	(54,900)	(93,432)
(a) Finance costs paid in cash		25,566	35,512
(b) Income taxes paid in cash		190,316	173,211
(c) Includes unrealized foreign exchange loss		1,000	—

XYZ Group

Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office and principal place of business is _____. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. Their principal activities are the manufacture and sale of candles.

2. Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the *International Financial Reporting Standard for Small and Medium-sized Entities* issued by the International Accounting Standards Board. They are presented in the currency units (CU) of A Land.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated.

Investments in associates

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the Group's right to receive payment has been established. It is included in other income.

Revenue recognition

Revenue from sales of goods is recognised when the goods are delivered and title has passed. Royalty revenue from licensing candle-making patents for use by others is recognised in accordance with the relevant licence agreements. Revenue is measured at the fair value of the consideration received or receivable, net of discounts and sales-related taxes collected on behalf of the government of A Land.

Borrowing costs

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (known as temporary differences). Deferred tax liabilities are generally recognised for all temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled (taxable temporary differences). Deferred tax assets are generally recognised for all temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered

or settled (deductible temporary differences)—but only to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are recognised in profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which it expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The following annual rates are used for the depreciation of property, plant and equipment:

Buildings	2 per cent
Fixtures and equipment	10–30 per cent

If there is an indication that there has been a significant change in depreciation rate, useful life or residual value of an asset, the depreciation of that asset is revised prospectively to reflect the new expectations.

Intangible assets

Intangible assets are purchased computer software that is stated at cost less accumulated depreciation and any accumulated impairment losses. It is amortised over its estimated life of five years using the straight-line method. If there is an indication that there has been a significant change in amortisation rate, useful life or residual value of an intangible asset, the amortisation is revised prospectively to reflect the new expectations.

Impairment of assets

At each reporting date, property, plant and equipment, intangible assets and investments in associates are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. If there is an indication of possible impairment, the recoverable amount of any affected asset (or group of related assets) is estimated and compared with its carrying amount. If estimated recoverable amount is lower, the carrying amount is reduced to its estimated recoverable amount, and an impairment loss is recognised immediately in profit or loss.

Similarly, at each reporting date, inventories are assessed for impairment by comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, its carrying amount is reduced

to selling price less costs to complete and sell, and an impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of related assets) is increased to the revised estimate of its recoverable amount (selling price less costs to complete and sell, in the case of inventories), but not in excess of the amount that would have been determined had no impairment loss been recognised for the asset (group of related assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership of the leased asset to the Group. All other leases are classified as operating leases.

Rights to assets held under finance leases are recognised as assets of the Group at the fair value of the leased property (or, if lower, the present value of minimum lease payments) at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are deducted in measuring profit or loss. Assets held under finance leases are included in property, plant and equipment, and depreciated and assessed for impairment losses in the same way as owned assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method.

Trade and other receivables

Most sales are made on the basis of normal credit terms and the receivables do not bear interest. Where credit is extended beyond normal credit terms, receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of trade and other receivables are reviewed to determine whether there is any objective evidence that the amounts are not recoverable. If so, an impairment loss is recognised immediately in profit or loss.

Trade payables

Trade payables are obligations on the basis of normal credit terms and do not bear interest. Trade payables denominated in a foreign currency are translated into CU using the exchange rate at the reporting date. Foreign exchange gains or losses are included in other income or other expenses.

Bank loans and overdrafts

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Employee benefits—long-service payment

The liability for employee benefit obligations relates to government-mandated long-service payments. All full-time staff, excluding directors, are covered by the programme. A payment is made of 5 per cent of salary (as determined for the twelve months before the payment) at the end of each of five years of

employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The Group's cost and obligation to make long-service payments to employees are recognised during the employees' periods of service. The cost and obligation are measured using the projected unit credit method, assuming a 4 per cent average annual salary increase, with employee turnover based on the Group's recent experience, discounted using the current market yield for high quality corporate bonds.

Provision for warranty obligations

All goods sold by the Group are warranted to be free of manufacturing defects for a period of one year. Goods are repaired or replaced at the Group's option. When revenue is recognised, a provision is made for the estimated cost of the warranty obligation.

3. Key sources of estimation uncertainty

Long-service payments

In determining the liability for long-service payments (explained in note 19), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation, and the number of employees expected to leave before they receive the benefits.

4. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

5. Revenue

	20X2 CU	20X1 CU
Sale of goods	6,743,545	5,688,653
Royalties – licensing of candle-making patents	120,000	120,000
	6,863,545	5,808,653

6. Other income

Other income includes dividends received from an associate of CU25,000 in both 20X1 and 20X2 and gain on disposal of property, plant and equipment of CU63,850 in 20X2.

7. Finance costs

	20X2 CU	20X1 CU
Interest on bank loan and overdraft	(21,250)	(30,135)
Interest on finance leases	(5,116)	(6,577)
	(26,366)	(36,712)

8. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2 CU	20X1 CU
Cost of inventories recognised as expense	5,178,530	4,422,575
Research and development cost (included in other expenses)	31,620	22,778
Foreign exchange loss on trade payables (included in other expenses)	1,000	—
Warranty expenses (included in cost of sales*)	5,260	7,340

*If the entity classifies its expenses by nature in its income statement, this would say 'included in raw materials and consumables used'.

9. Income tax expense

	20X2 CU	20X1 CU
Current tax	271,647	190,316
Deferred tax (note 15)	(1,397)	(757)
	270,250	189,559

Income tax is calculated at 40 per cent (20X1: 40 per cent) of the estimated assessable profit for the year.

Income tax expense for the year CU270,250 in 20X2 (CU189,559 in 20X1) differs from the amount that would result from applying the tax rate of 40 per cent (both 20X2 and 20X1) to profit before tax because, under the tax laws of A Land, some employee compensation expenses (CU20,670 in 20X2 and CU16,750 in 20X1) that are recognised in measuring profit before tax are not tax-deductible.

10. Trade and other receivables

	20X2 CU	20X1 CU
Trade debtors	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

11. Inventories

	20X2 CU	20X1 CU
Raw materials	42,601	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
	57,381	47,920

12. Investment in associate

The Group owns 35 per cent of an associate whose shares are not publicly traded.

	20X2 CU	20X1 CU
Cost of investment in associate	107,500	107,500
Dividend received from associate (included in other income)	25,000	25,000

13. Property, plant and equipment

	Land and buildings CU	Fixtures and equipment CU	Total CU
Cost			
1 January 20X2	1,960,000	1,102,045	3,062,045
Additions	—	485,000	485,000
Disposals	—	(241,000)	(241,000)
31 December 20X2	1,960,000	1,346,045	3,306,045
Accumulated depreciation and impairment			
1 January 20X2	390,000	270,590	660,590
Annual depreciation	30,000	240,360	270,360
Impairment	—	30,000	30,000
Less accumulated depreciation on assets disposed of	—	(204,850)	(204,850)
31 December 20X2	420,000	336,100	756,100
Carrying amount			
31 December 20X2	1,540,000	1,009,945	2,549,945

During 20X2 the Group noticed a significant decline in the efficiency of a major piece of equipment and so carried out a review of its recoverable amount. The review led to the recognition of an impairment loss ofCU30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU40,000 (20X1: CU60,000) in respect of assets held under finance leases.

On 10 December 20X2 the directors resolved to dispose of a machine. The machine's carrying amount of CU1,472 is included in fixtures and equipment at 31 December 20X2, and trade payables includes the Group's remaining obligation of CU1,550 on the acquisition of this machine. Because the proceeds on disposal are expected to exceed the net carrying amount of the asset and related liability, no impairment loss has been recognised.

14. Intangible assets

Software:

Cost	**CU**
1 January 20X2	8,500
Additions	—
Disposals	—
31 December 20X2	8,500
Accumulated depreciation and impairment	
1 January 20X2	5,950
Annual amortisation (included in administrative expenses*)	1,700
31 December 20X2	7,650
Carrying amount	
31 December 20X2	850

*If the entity classifies its expenses by nature in its income statement, this would say 'included in depreciation and amortisation expense'.

15. Deferred tax

Differences between amounts recognised in the income statement and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax assets are the tax effects of expected future income tax benefits relating to:

(a) the long-service benefit (note 19), which will not be tax-deductible until the benefit is actually paid but has already been recognised as an expense in measuring the Group's profit for the year.

(b) the foreign exchange loss on trade payables, which will not be tax-deductible until the payables are settled but has already been recognised as an expense in measuring the Group's profit for the year.

Management considers it probable that taxable profits will be available against which the future income tax deductions can be utilised.

The following are deferred tax liabilities (assets) recognized by the Group:

	Software	**Foreign exchange loss**	**Long-service benefit**	**Total**
	CU	**CU**	**CU**	**CU**
1 January 20X1	1,700	—	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	—	(77)	(757)
1 January 20X2	1,020	—	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(400)	(317)	(1,397)
31 December 20X2	340	(400)	(4,249)	(4,309)

The deferred tax assets for the foreign exchange loss and the long-service benefits and the deferred tax liability for software relate to income tax in the same jurisdiction, and the law allows net settlement. Consequently, they have been offset in the statement of financial position as follows:

	20X2 CU	20X1 CU
Deferred tax liability	340	1,020
Deferred tax asset	(4,649)	(3,932)
	(4,309)	(2,912)

16. Bank overdraft and loan

	20X2 CU	20X1 CU
Bank overdraft	83,600	115,507
Bank loan — fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600	265,507

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU266,000 at 31 December 20X2 (CU412,000 at 31 December 20X1).

Interest is payable on the bank overdraft at 200 points above the London Interbank Borrowing Rate (LIBOR). Interest is payable on the seven-year bank loan at a fixed rate of 5 per cent of the principal amount.

17. Trade payables

Trade payables at 31 December 20X2 include CU42,600 denominated in foreign currencies (nil at 31 December 20X1).

18. Provision for warranty obligations

Changes in the provision for warranty obligations during 20X2 were:

	20X2 CU
1 January 20X2	5,040
Additional accrual during the year	5,260
Cost of warranty repairs and replacement during the year	(6,100)
31 December 20X2	4,200

The obligation is classified as a current liability because the warranty is limited to twelve months.

19. Employee benefit obligation-long-service payments

The Group's employee benefit obligation for long-service payments under a government-mandated plan is based on a comprehensive actuarial valuation as of 31 December 20X2 and is as follows:

	20X2
	CU
Obligation at 1 January 20X2	9,830
Additional accrual during the year	7,033
Benefit payments made in year	(6,240)
Obligation at 31 December 20X2	10,623

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	4,944	4,754
Non-current liability	5,679	5,076
Total	10,623	9,830

20. Obligations under finance leases

The Group holds one piece of specialised machinery with an estimated useful life of five years under a five-year finance lease. The future minimum lease payments are as follows:

	20X2	20X1
	CU	CU
Within one year	25,000	25,000
Later than one year but within five years	25,000	50,000
Later than five years	—	—
	50,000	75,000

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	21,461	19,884
Non-current liability	23,163	44,624
	44,624	64,508

21. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years, with fixed rentals over the same period.

	20X2 CU	20X1 CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2 CU	20X1 CU
Within one year	13,050	26,100
Later than one year but within five years	—	13,050
Later than five years	—	—
	13,050	39,150

22. Share capital

Balances as at 31 December 20X2 and 20X1 of CU30,000 comprise 30,000 ordinary shares with par value CU1.00 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised but unissued.

23. Cash and cash equivalents

	20X2 CU	20X1 CU
Cash on hand	28,700	22,075
Overdrafts	(83,600)	(115,507)
	(54,900)	(93,432)

24. Contingent liabilities

During 20X2 a customer initiated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU50,000 and has initiated litigation claiming this amount.

The Group's legal counsel do not consider that the claim has merit and the Company intends to contest it. No provision has been recognised in these financial statements as the Group's management does not consider it probable that a loss will arise.

25. Events after the end of the reporting period

On 25 January 20X3 there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU36,000. The reimbursements from insurance are estimated to be CU16,000.

On 14 February 20X3 the directors voted to declare a dividend of CU1.00 per share (CU30,000 total) payable on 15 April 20X3 to registered shareholders on 31 March 20X3. Because the obligation arose in 20X3, a liability is not shown in the statement of financial position at 31 December 20X2.

26. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 12), which is a related party, as follows:

	Sales of goods		Amounts owed to the Group by the related party and included in trade receivables at year-end	
	20X2	**20X1**	**20X2**	**20X1**
	CU	**CU**	**CU**	**CU**
Associate	10,000	8,000	800	400

The payments under the finance lease (see note 20) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The total remuneration of directors and other members of key management in 20X2 (including salaries and benefits) was CU249,918 (20X1: CU208,260).

27. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 20X3.

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Table of Presentation and Disclosure Requirements by Section

This table has been derived from the presentation and disclosure requirements in the IFRS for SMEs*.*

D1 This table collects together the presentation and disclosure requirements in the *IFRS for SMEs* for ease of reference when preparing the financial statements.

D2 This table deals with both presentation and disclosures. Often a required presentation is the equivalent of a disclosure requirement. To illustrate, Sections 3 *Financial Statement Presentation*, Section 4 *Statement of Financial Position*, Section 5 *Statement of Comprehensive Income and Income Statement* and Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings* of the Standard require the presentation of some specific line items in the statement of financial position, statement of comprehensive income, income statement (if presented), statement of changes in equity and statement of cash flows.

D3 In most cases, the Standard does not specify whether a disclosure should be made within a financial statement or in the notes. In several cases, however, disclosures are expressly required to be in a financial statement; these are identified in this table.

D4 Some requirements specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by the *IFRS for SMEs* or present a separate line item if the information resulting from that disclosure is not material. This is the case even if the *IFRS for SMEs* contains a list of specific requirements or describes them as minimum requirements. The concept of materiality is discussed in paragraph 2.6.

D5 The application of the *IFRS for SMEs*, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows of an entity eligible to use the Standard. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in the *IFRS for SMEs* is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance. An entity must present additional line items, headings and subtotals in the financial statements when such presentation is relevant to an understanding of the entity's financial position, performance and changes in financial position. Similarly, an entity must include in the notes to financial statements information that is not presented elsewhere in the financial statements but is relevant to an understanding of them.

Section 1 *Small and Medium-sized Entities*

No presentation or disclosure requirements in this section.

Section 2 *Concepts and Pervasive Principles*

No presentation or disclosure requirements in this section.

Section 3 *Financial Statement Presentation*

Compliance with the *IFRS for SMEs*

3.3	An entity whose financial statements comply with the *IFRS for SMEs* shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with the *IFRS for SMEs* unless they comply with all the requirements of this Standard.
3.5	When an entity departs from a requirement of this Standard in accordance with paragraph 3.4, it shall disclose the following: (a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows; (b) that it has complied with the *IFRS for SMEs*, except that it has departed from a particular requirement to achieve a fair presentation; and (c) the nature of the departure, including the treatment that the *IFRS for SMEs* would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2 and the treatment adopted.
3.6	When an entity has departed from a requirement of this Standard in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.5(c).
3.7	In the extremely rare circumstances when management concludes that compliance with a requirement in this Standard would be so misleading that it would conflict with the objective of financial statements of SMEs set out in Section 2, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing the following: (a) the nature of the requirement in this Standard, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in Section 2; and (b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.
3.9	When management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Frequency of reporting

3.10	An entity shall present a complete set of financial statements (including comparative information–see paragraph 3.14) at least annually. When the end of an entity's reporting period changes and the annual financial statements are presented for a period longer or shorter than one year, the entity shall disclose the following: (a) that fact; (b) the reason for using a longer or shorter period; and (c) the fact that comparative amounts presented in the financial statements (including the related notes) are not entirely comparable.

Consistency of presentation

3.12	When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is impracticable. When comparative amounts are reclassified, an entity shall disclose the following: (a) the nature of the reclassification; (b) the amount of each item or class of items that is reclassified; and (c) the reason for the reclassification.
3.13	If it is impracticable to reclassify comparative amounts, an entity shall disclose why reclassification was not practicable.

Comparative information

3.14	Except when this Standard permits or requires otherwise, an entity shall disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Materiality and aggregation

3.15	An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

Complete set of financial statements

3.17	A complete set of financial statements of an entity shall include all of the following: (a) a statement of financial position as at the reporting date; (b) either: (i) a single statement of comprehensive income for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining profit or loss (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income. (ii) a separate income statement and a separate statement of comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income. (c) a statement of changes in equity for the reporting period; (d) a statement of cash flows for the reporting period; and (e) notes, comprising a summary of significant accounting policies and other explanatory information.
3.18	If the only changes to the equity of an entity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy, the entity may present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity (see paragraph 6.4).
3.19	If an entity has no items of other comprehensive income in any of the periods for which financial statements are presented, it may present only an income statement or it may present a statement of comprehensive income in which the 'bottom line' is labelled 'profit or loss'.
3.20	Because paragraph 3.14 requires comparative amounts in respect of the previous period for all amounts presented in the financial statements, a complete set of financial statements means that an entity shall present, as a minimum, two of each of the required financial statements and related notes.
3.21	In a complete set of financial statements, an entity shall present each financial statement with equal prominence.

Identification of the financial statements

3.23	An entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. In addition, an entity shall display the following information prominently and repeat it when necessary for an understanding of the information presented: (a) the name of the reporting entity and any change in its name since the end of the preceding reporting period; (b) whether the financial statements cover the individual entity or a group of entities; (c) the date of the end of the reporting period and the period covered by the financial statements; (d) the presentation currency, as defined in Section 30 *Foreign Currency Translation*; and
	continued…

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	(e) the level of rounding, if any, used in presenting amounts in the financial statements.
3.24	An entity shall disclose the following in the notes: (a) the domicile and legal form of the entity, its country of incorporation and the address of its 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.

Presentation of information not required by this Standard

3.25	This Standard does not address presentation of segment information, earnings per share, or interim financial reports by a small or medium-sized entity. An entity making such disclosures shall describe the basis for preparing and presenting the information.

Section 4 *Statement of Financial Position*

Information to be presented in the statement of financial position

4.2	As a minimum, the statement of financial position shall include line items that present the following amounts: (a) cash and cash equivalents; (b) trade and other receivables; (c) financial assets (excluding amounts shown under (a), (b) (i) and (j)); (d) inventories; (e) property, plant and equipment; (ea) investment property carried at cost less accumulated depreciation and impairment; (f) investment property carried at fair value through profit or loss; (g) intangible assets; (h) biological assets carried at cost less accumulated depreciation and impairment; (i) biological assets carried at fair value through profit or loss; (j) investments in associates; (k) investments in jointly controlled entities; (l) trade and other payables; (m) financial liabilities (excluding amounts shown under (l) and (p)); (n) liabilities and assets for current tax; (o) deferred tax liabilities and deferred tax assets (these shall always be classified as non-current); (p) provisions; (q) non-controlling interest, presented within equity separately from the equity attributable to the owners of the parent; and (r) equity attributable to the owners of the parent.
4.3	An entity shall present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

Current/non-current distinction

4.4	An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 4.5–4.8, except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity (ascending or descending).

Sequencing of items and format of items in the statement of financial position

4.9	This Standard does not prescribe the sequence or format in which items are to be presented. Paragraph 4.2 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition: (a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and (b) the descriptions used and the sequencing of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position.

Information to be presented either in the statement of financial position or in the notes

4.11	An entity shall disclose, either in the statement of financial position or in the notes, the following subclassifications of the line items presented: (a) property, plant and equipment in classifications appropriate to the entity; (b) trade and other receivables showing separately amounts due from related parties, amounts due from other parties and receivables arising from accrued income not yet billed; (c) inventories, showing separately amounts of inventories: (i) held for sale in the ordinary course of business; (ii) in the process of production for such sale; and (iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services. (d) trade and other payables, showing separately amounts payable to trade suppliers, payable to related parties, deferred income, and accruals; (e) provisions for employee benefits and other provisions; and (f) classes of equity, such as paid-in capital, share premium, retained earnings and items of income and expense that, as required by this Standard, are recognised in other comprehensive income and presented separately in equity.
	continued…

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4.12	An entity with share capital shall disclose the following, either in the statement of financial position 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. This reconciliation need not be presented for prior periods. (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 or by its subsidiaries or associates. (vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts. (b) a description of each reserve within equity.
4.13	An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.12(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.
4.14	If, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a group of assets and liabilities, the entity shall disclose the following information: (a) a description of the asset(s) or the group of assets and liabilities; (b) a description of the facts and circumstances of the sale or plan; and (c) the carrying amount of the assets or, if the disposal involves a group of assets and liabilities, the carrying amounts of those assets and liabilities.

Section 5 *Statement of Comprehensive Income and Income Statement*

Presentation of total comprehensive income

5.2	An entity shall present its total comprehensive income for a period either: (a) in a single statement of comprehensive income, in which case the statement of comprehensive income presents all items of income and expense recognised in the period; or (b) in two statements–an income statement and a statement of comprehensive income–in which case the income statement presents all items of income and expense recognised in the period except those that are recognised in total comprehensive income outside profit or loss as permitted or required by this Standard .
5.5	As a minimum, an entity shall include, in the statement of comprehensive income, line items that present the following amounts for the period: (a) revenue. (b) finance costs. (c) share of the profit or loss of investments in associates (see Section 14 *Investments in Associates*) and jointly controlled entities (see Section 15 *Investments in Joint Ventures*) accounted for using the equity method. (d) tax expense excluding tax allocated to items (e), (g) and (h) below (see paragraph 29.35). (e) a single amount comprising the total of: (i) the post-tax profit or loss of a discontinued operation; and (ii) the post-tax gain or loss attributable to an impairment, or reversal of an impairment, of the assets in the discontinued operation (see Section 27 *Impairment of Assets*), both at the time and subsequent to being classified as a discontinued operation and to the disposal of the net assets constituting the discontinued operation. (f) profit or loss (if an entity has no items of other comprehensive income, this line need not be presented). (g) each item of other comprehensive income (see paragraph 5.4(b)) classified by nature (excluding amounts in (h)). Such items shall be grouped into those that, in accordance with this Standard: (i) will not be reclassified subsequently to profit or loss—ie those in paragraph 5.4(b)(i)–(ii) and (iv); and (ii) will be reclassified subsequently to profit or loss when specific conditions are met—ie those in paragraph 5.4(b)(iii). (h) share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method. (i) total comprehensive income (if an entity has no items of other comprehensive income, it may use another term for this line such as profit or loss).
	continued…

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5.6	An entity shall disclose separately the following items in the statement of comprehensive income as allocations for the period: (a) profit or loss for the period attributable to: (i) non-controlling interest; and (ii) owners of the parent. (b) total comprehensive income for the period attributable to: (i) non-controlling interest; and (ii) owners of the parent.

Requirements applicable to both approaches

5.8	Under this Standard, the effects of corrections of errors and changes in accounting policies are presented as retrospective adjustments of prior periods instead of as part of profit or loss in the period in which they arise (see Section 10 *Accounting Policies, Estimates and Errors*).
5.9	An entity shall present additional line items, headings and subtotals in the statement of comprehensive income (and in the income statement, if presented), when such presentation is relevant to an understanding of the entity's financial performance.
5.10	An entity shall not present or describe any items of income and expense as 'extraordinary items' in the statement of comprehensive income (or in the income statement, if presented) or in the notes.

Analysis of expenses

5.11	An entity shall present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant. **Analysis by nature of expense** (a) Under this method of classification, expenses are aggregated in the statement of comprehensive income according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs) and are not reallocated among various functions within the entity. **Analysis by function of expense** (b) Under this method of classification, expenses are aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*

Information to be presented in the statement of changes in equity

6.3	The statement of changes in equity includes the following information: (a) total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests; (b) for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Section 10 *Accounting Policies, Estimates and Errors*; and (c) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from: (i) profit or loss; (ii) each item of other comprehensive income; and (iii) the amounts of investments by, and dividends and other distributions to, owners in their capacity as owners, showing separately issues of shares, treasury share transactions, dividends and other distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

Information to be presented in the statement of income and retained earnings

6.5	An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by Section 5 *Statement of Comprehensive Income and Income Statement*: (a) retained earnings at the beginning of the reporting period; (b) dividends declared and paid or payable during the period; (c) restatements of retained earnings for corrections of prior period errors; (d) restatements of retained earnings for changes in accounting policy; and (e) retained earnings at the end of the reporting period.

Section 7 *Statement of Cash Flows*

Information to be presented in the statement of cash flows

7.3	An entity shall present a statement of cash flows that presents cash flows for a reporting period classified by operating activities, investing activities and financing activities.

Reporting cash flows from operating activities

7.7	An entity shall present cash flows from operating activities using either: (a) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments and items of income or expense associated with investing or financing cash flows; or (b) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.

Reporting cash flows from investing and financing activities

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

Interest and dividends

7.14	An entity shall present separately cash flows from interest and dividends received and paid. The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.

Income tax

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

Non-cash transactions

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

Components of cash and cash equivalents

7.20	An entity shall present the components of cash and cash equivalents and shall present a reconciliation of the amounts presented in the statement of cash flows to the equivalent items presented in the statement of financial position. However, an entity is not required to present this reconciliation if the amount of cash and cash equivalents reported in the statement of cash flows is identical to the amount similarly described in the statement of financial position.

Other disclosures

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

Section 8 *Notes to the Financial Statements*

Structure of the notes

8.2	The notes shall: (a) present information about the basis of preparation of the financial statements and the specific accounting policies used, in accordance with paragraphs 8.5–8.7; (b) disclose the information required by this Standard that is not presented elsewhere in the financial statements; and (c) provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.
8.3	An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.
8.4	An entity normally presents the notes in the following order: (a) a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs* (see paragraph 3.3); (b) a summary of significant accounting policies applied (see paragraph 8.5); (c) supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and (d) any other disclosures.

Disclosure of accounting policies

8.5	An entity shall disclose the following in the summary of significant accounting policies: (a) the measurement basis (or bases) used in preparing the financial statements; (b) the other accounting policies used that are relevant to an understanding of the financial statements.

Information about judgements

8.6	An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Information about key sources of estimation uncertainty

8.7	An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature; and (b) their carrying amount as at the end of the reporting period.

Section 9 *Consolidated and Separate Financial Statements*

Requirement to present consolidated financial statements

9.2	Except as permitted or required by paragraph 9.3 and 9.3C, a parent entity shall present consolidated financial statements in which it consolidates its investments in subsidiaries. Consolidated financial statements shall include all subsidiaries of the parent.
9.3	A parent need not present consolidated financial statements if both of the following conditions are met: (a) the parent is itself a subsidiary; and (b) its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full IFRS or with this Standard.
9.3C	If a parent has no subsidiaries other than subsidiaries that are not required to be consolidated in accordance with paragraphs 9.3A–9.3B, it shall not present consolidated financial statements. However, the parent shall provide the disclosure in paragraph 9.23A.

Non-controlling interest in subsidiaries

9.20	An entity shall present non-controlling interest in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent, as required by paragraph 4.2(q).
9.21	An entity shall disclose non-controlling interest in the profit or loss of the group separately in the statement of comprehensive income, as required by paragraph 5.6 (or in the income statement, if presented, as required by paragraph 5.7).

Disclosures in consolidated financial statements

9.23	The following disclosures shall be made in consolidated financial statements: (a) the fact that the statements are consolidated financial statements; (b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power; (c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements; and (d) the nature and extent of any significant restrictions (for example, resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.
9.23A	In addition to the disclosure requirements in Section 11, a parent entity shall disclose the carrying amount of investments in subsidiaries that are not consolidated (see paragraphs 9.3A–9.3C) at the reporting date, in total, either in the statement of financial position or in the notes.

Disclosures in separate financial statements

9.27	When a parent, an investor in an associate or a venturer with an interest in a jointly controlled entity prepares separate financial statements, those separate financial statements shall disclose: (a) that the statements are separate financial statements; and (b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates, and shall identify the consolidated financial statements or other primary financial statements to which they relate.

Disclosures in combined financial statements

9.30	The combined financial statements shall disclose the following: (a) the fact that the financial statements are combined financial statements; (b) the reason why combined financial statements are prepared; (c) the basis for determining which entities are included in the combined financial statements; (d) the basis of preparation of the combined financial statements; and (e) the related party disclosures required by Section 33 *Related Party Disclosures*.

Section 10 *Accounting Policies, Estimates and Errors*

Disclosure of a change in accounting policy

10.13	When an amendment to this Standard has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose the following: (a) the nature of the change in accounting policy; (b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected; (c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and (d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c). Financial statements of subsequent periods need not repeat these disclosures.
10.14	When a voluntary change in accounting policy has an effect on the current period or any prior period, an entity shall disclose the following: (a) the nature of the change in accounting policy; (b) the reasons why applying the new accounting policy provides reliable and more relevant information; (c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately: (i) for the current period; (ii) for each prior period presented; and (iii) in the aggregate for periods before those presented. (d) an explanation if it is impracticable to determine the amounts to be disclosed in (c). Financial statements of subsequent periods need not repeat these disclosures.

Disclosure of a change in estimate

10.18	An entity shall disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expense for the current period. If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.

Disclosure of prior period errors

10.23	An entity shall disclose the following about prior period errors: (a) the nature of the prior period error; (b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected; (c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented; and (d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c) . Financial statements of subsequent periods need not repeat these disclosures.

Section 11 *Basic Financial Instruments*

Disclosures

11.39	The disclosures below make reference to disclosures for financial liabilities measured at fair value through profit or loss. Entities that have only basic financial instruments (and therefore do not apply Section 12 *Other Financial Instrument Issues*) will not have any financial liabilities measured at fair value through profit or loss and hence will not need to provide such disclosures.

Disclosure of accounting policies for financial instruments

11.40	In accordance with paragraph 8.5, an entity shall disclose, in the summary of significant accounting policies, the measurement basis (or bases) used for financial instruments and the other accounting policies used for financial instruments that are relevant to an understanding of the financial statements.

Statement of financial position – categories of financial assets and financial liabilities

11.41	An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities at the reporting date, in total, either in the statement of financial position or in the notes: (a) financial assets measured at fair value through profit or loss (paragraph 11.14(c)(i) and paragraphs 12.8 and 12.9); (b) financial assets that are debt instruments measured at amortised cost (paragraph 11.14(a)); (c) financial assets that are equity instruments measured at cost less impairment (paragraph 11.14(c)(ii) and paragraphs 12.8 and 12.9); (d) financial liabilities measured at fair value through profit or loss (paragraphs 12.8 and 12.9); (e) financial liabilities measured at amortised cost (paragraph 11.14(a)); and (f) loan commitments measured at cost less impairment (paragraph 11.14(b)).
11.42	An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment schedule, and restrictions that the debt instrument imposes on the entity).
11.43	For all financial assets and financial liabilities measured at fair value, the entity shall disclose the basis for determining fair value, for example, quoted market price in an active market or a valuation technique. When a valuation technique is used, the entity shall disclose the assumptions applied in determining fair value for each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.
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11.44	If a reliable measure of fair value is no longer available, or is not available without undue cost or effort when such an exemption is provided, for any financial instruments that would otherwise be required to be measured at fair value through profit or loss in accordance with this Standard, the entity shall disclose that fact, the carrying amount of those financial instruments and, if an undue cost or effort exemption has been used, the reasons why a reliable fair value measurement would involve undue cost or effort.

Derecognition

11.45	If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.33–11.35), the entity shall disclose the following for each class of such financial assets: (a) the nature of the assets; (b) the nature of the risks and rewards of ownership to which the entity remains exposed; and (c) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

11.46	When an entity has pledged financial assets as collateral for liabilities or contingent liabilities, it shall disclose the following: (a) the carrying amount of the financial assets pledged as collateral; and (b) the terms and conditions relating to its pledge.

Defaults and breaches on loans payable

11.47	For loans payable recognised at the reporting date for which there is a breach of terms or default of principal, interest, sinking fund or redemption terms that has not been remedied by the reporting date, an entity shall disclose the following: (a) details of that breach or default; (b) the carrying amount of the related loans payable at the reporting date; and (c) whether the breach or default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

Items of income, expense, gains or losses

11.48	An entity shall disclose the following items of income, expense, gains or losses: (a) income, expense, gains or losses, including changes in fair value, recognised on: (i) financial assets measured at fair value through profit or loss; (ii) financial liabilities measured at fair value through profit or loss; (iii) financial assets measured at amortised cost; and (iv) financial liabilities measured at amortised cost. (b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not measured at fair value through profit or loss; and (c) the amount of any impairment loss for each class of financial asset.

Section 12 *Other Financial Instruments Issues*

Disclosures

12.26	An entity applying this section shall make all of the disclosures required in Section 11 *Basic Financial Instruments* incorporating in those disclosures financial instruments that are within the scope of this section as well as those within the scope of Section 11. In addition, if the entity uses hedge accounting, it shall make the additional disclosures in paragraphs 12.27–12.29.
12.27	An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 12.17: (a) a description of the hedge; (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and (c) the nature of the risks being hedged, including a description of the hedged item.
12.28	If an entity uses hedge accounting for a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 12.19–12.22) it shall disclose the following: (a) the amount of the change in fair value of the hedging instrument recognised in profit or loss for the period; and (b) the amount of the change in fair value of the hedged item recognised in profit or loss for the period.
12.29	If an entity uses hedge accounting for a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction or a net investment in a foreign operation (paragraphs 12.23–12.25), it shall disclose the following: (a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss; (b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur; (c) the amount of the change in fair value of the hedging instrument that was recognised in other comprehensive income during the period (paragraph 12.23). (d) the amount that was reclassified to profit or loss for the period (paragraphs 12.23 and 12.25); and (e) the amount of any excess of the cumulative change in fair value of the hedging instrument over the cumulative change in the fair value of the expected cash flows that was recognised in profit or loss for the period (paragraph 12.23).

Section 13 *Inventories*

Disclosures

13.22	An entity shall disclose the following: (a) the accounting policies adopted in measuring inventories, including the cost formula used; (b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity; (c) the amount of inventories recognised as an expense during the period; (d) impairment losses recognised or reversed in profit or loss in accordance with Section 27 *Impairment of Assets*; and (e) the total carrying amount of inventories pledged as security for liabilities.

Section 14 *Investments in Associates*

Financial statement presentation

14.11	An investor shall classify investments in associates as non-current assets.

Disclosures

14.12	An entity shall disclose the following: (a) its accounting policy for investments in associates; (b) the carrying amount of investments in associates (see paragraph 4.2(j)); and (c) the fair value of investments in associates accounted for using the equity method for which there are published price quotations.
14.13	For investments in associates accounted for by the cost model, an investor shall disclose the amount of dividends and other distributions recognised as income.
14.14	For investments in associates accounted for by the equity method, an investor shall disclose separately its share of the profit or loss of such associates and its share of any discontinued operations of such associates.
14.15	For investments in associates accounted for by the fair value model, an investor shall make the disclosures required by paragraphs 11.41–11.44. If an investor applies the undue cost or effort exemption in paragraph 14.10 for any associates it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in associates accounted for under the cost model.

Section 15 *Investments in Joint Ventures*

Disclosures

15.19	An entity shall disclose the following: (a) the accounting policy it uses for recognising its interests in jointly controlled entities; (b) the carrying amount of investments in jointly controlled entities (see paragraph 4.2(k)); (c) the fair value of investments in jointly controlled entities accounted for using the equity method for which there are published price quotations; and (d) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves.
15.20	For jointly controlled entities accounted for in accordance with the equity method, the venturer shall also make the disclosures required by paragraph 14.14 for equity method investments.
15.21	For jointly controlled entities accounted for in accordance with the fair value model, the venturer shall make the disclosures required by paragraphs 11.41–11.44. If a venturer applies the undue cost or effort exemption in paragraph 15.15 for any jointly controlled entity it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in jointly controlled entities accounted for under the cost model.

Section 16 *Investment Property*

Disclosures

16.10	An entity shall disclose the following for all investment property accounted for at fair value through profit or loss (paragraph 16.7): (a) the methods and significant assumptions applied in determining the fair value of investment property. (b) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed. (c) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal. (d) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements. (e) a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately: (i) additions, disclosing separately those additions resulting from acquisitions through business combinations; (ii) net gains or losses from fair value adjustments; (iii) transfers to and from investment property carried at cost less accumulated depreciation and impairment (see paragraph 16.8); (iv) transfers to and from inventories and owner-occupied property; and (v) other changes. This reconciliation need not be presented for prior periods.
16.11	In accordance with Section 20 *Leases*, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance lease or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

Section 17 *Property, Plant and Equipment*

Disclosures

17.31	An entity shall disclose the following for each class of property, plant and equipment determined in accordance with paragraph 4.11(a) and separately for investment property carried at cost less accumulated depreciation and impairment: (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 reporting period; and (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately: (i) additions; (ii) disposals; (iii) acquisitions through business combinations; (iv) increases or decreases resulting from revaluations under paragraphs 17.15B–17.15D and from impairment losses recognised or reversed in other comprehensive income in accordance with Section 27; (v) transfers to and from investment property carried at fair value through profit or loss (see paragraph 16.8); (vi) impairment losses recognised or reversed in profit or loss in accordance with Section 27 *Impairment of Assets*; (vii) depreciation; and (viii) other changes. This reconciliation need not be presented for prior periods.
17.32	An entity shall also disclose the following: (a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for liabilities; (b) the amount of contractual commitments for the acquisition of property, plant and equipment; and (c) if an entity has investment property whose fair value cannot be measured reliably without undue cost or effort it shall disclose that fact and the reasons why fair value measurement would involve undue cost or effort for those items of investment property.
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17.33	If items of property, plant and equipment are stated at revalued amounts, an entity shall disclose the following: (a) the effective date of the revaluation; (b) whether an independent valuer was involved; (c) the methods and significant assumptions applied in estimating the items' fair values; (d) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and (e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Section 18 *Intangible Assets other than Goodwill*

Disclosures

18.27	An entity shall disclose the following for each class of intangible assets: (a) the useful lives or the amortisation rates used; (b) the amortisation methods used; (c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period; (d) the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which any amortisation of intangible assets is included; and (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately: (i) additions; (ii) disposals; (iii) acquisitions through business combinations; (iv) amortisation; (v) impairment losses; (vi) other changes. This reconciliation need not be presented for prior periods.
18.28	An entity shall also disclose: (a) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements; (b) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 18.12): (i) the fair value initially recognised for these assets; and (ii) their carrying amounts. (c) the existence and carrying amounts of intangible assets to which the entity has restricted title or that are pledged as security for liabilities; and (d) the amount of contractual commitments for the acquisition of intangible assets.
18.29	An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period (ie the amount of expenditure incurred internally on research and development that has not been capitalised as part of the cost of another asset that meets the recognition criteria in this Standard).

Section 19 *Business Combinations and Goodwill*

Disclosures for business combination(s) during the reporting period

19.25	For each business combination during the period, the acquirer shall disclose the following: (a) the names and descriptions of the combining entities or businesses; (b) the acquisition date; (c) the percentage of voting equity instruments acquired; (d) the cost of the combination and a description of the components of that cost (such as cash, equity instruments and debt instruments); (e) the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, including goodwill; (f) the amount of any excess recognised in profit or loss in accordance with paragraph 19.24, and the line item in the statement of comprehensive income (and in the income statement, if presented) in which the excess is recognised; and (g) a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, or intangible assets or other items not recognised in accordance with paragraph 19.15.

Disclosures for all business combinations

19.26	An acquirer shall disclose the useful lives used for goodwill and a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing separately: (a) changes arising from new business combinations; (b) impairment losses; (c) disposals of previously acquired businesses; and (d) other changes. This reconciliation need not be presented for prior periods.

Section 20 *Leases*

Financial statements of lessees – finance leases

20.13	A lessee shall make the following disclosures for finance leases: (a) for each class of asset, the net carrying amount at the end of the reporting period; (b) the total of future minimum lease payments at the end of the reporting period, for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; and (iii) later than five years. (c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.
20.14	In addition, the requirements for disclosure about assets in accordance with Section17 *Property, Plant and Equipment*, Section 18 *Intangible Assets other than Goodwill*, Section 27 *Impairment of Assets* and Section 34 *Specialised Assets* apply to lessees for assets leased under finance leases.

Financial statements of lessees – operating leases

20.16	A lessee shall make the following disclosures for operating leases: (a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; and (iii) later than five years. (b) lease payments recognised as an expense; and (c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases and restrictions imposed by lease arrangements.

Financial statements of lessors – finance leases

20.23	A lessor shall make the following disclosures for finance leases: (a) a reconciliation between the gross investment in the lease at the end of the reporting period and the present value of minimum lease payments receivable at the end of the reporting period. In addition, a lessor shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the end of the reporting period, for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; and (iii) later than five years. (b) unearned finance income. (c) the unguaranteed residual values accruing to the benefit of the lessor. (d) the accumulated allowance for uncollectible minimum lease payments receivable. (e) contingent rents recognised as income in the period. (f) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Financial statements of lessors – operating leases

20.30	A lessor shall disclose the following for operating leases: (a) the future minimum lease payments under non-cancellable operating leases for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; and (iii) later than five years. (b) total contingent rents recognised as income; and (c) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses and restrictions imposed by lease arrangements.
20.31	In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessors for assets provided under operating leases.

Sale and leaseback transactions

20.35	Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of significant leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

Section 21 *Provisions and Contingencies*

Disclosures about provisions

21.14	For each class of provision, an entity shall disclose all of the following: (a) a reconciliation showing (i) the carrying amount at the beginning and end of the period; (ii) additions during the period, including adjustments that result from changes in measuring the discounted amount; (iii) amounts charged against the provision during the period; and (iv) unused amounts reversed during the period. (b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments; (c) an indication of the uncertainties about the amount or timing of those outflows; and (d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement. Comparative information for prior periods is not required.

Disclosures about contingent liabilities

21.15	Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, when practicable: (a) an estimate of its financial effect, measured in accordance with paragraphs 21.7–21.11; (b) an indication of the uncertainties relating to the amount or timing of any outflow; and (c) the possibility of any reimbursement. If it is impracticable to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

21.16	If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the contingent assets at the end of the reporting period and, unless it would involve undue cost or effort, an estimate of their financial effect, measured using the principles set out in paragraphs 21.7–21.11. If such an estimate would involve undue cost or effort, the entity shall disclose that fact and the reasons why estimating the financial effect would involve undue cost or effort.

Prejudicial disclosures

21.17	In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14–21.16 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 shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Section 22 *Liabilities and Equity*

Disclosures

22.20	If the fair value of the assets to be distributed as described in paragraphs 22.18–22.18A cannot be measured reliably without undue cost or effort, the entity shall disclose that fact and the reasons why a reliable fair value measurement would involve undue cost or effort.

Section 23 *Revenue*

General disclosures about revenue

23.30	An entity shall 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; and (b) the amount of each category of revenue recognised during the period, showing separately, at a minimum, revenue arising from: (i) the sale of goods; (ii) the rendering of services; (iii) interest; (iv) royalties; (v) dividends; (vi) commissions; (vii) government grants; and (viii) any other significant types of revenue.

Disclosures relating to revenue from construction contracts

23.31	An entity shall disclose the following: (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.
23.32	An entity shall 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.

Section 24 *Government Grants*

Disclosures

24.6	An entity shall disclose the following: (a) the nature and amounts of government grants recognised in the financial statements; (b) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income; and (c) an indication of other forms of government assistance from which the entity has directly benefited.
24.7	For the purpose of the disclosure required by paragraph 24.6(c), government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. Examples include free technical or marketing advice, the provision of guarantees and loans at nil or low interest rates.

Section 25 *Borrowing Costs*

Disclosures

25.3	Paragraph 5.5(b) requires disclosure of finance costs. Paragraph 11.48(b) requires disclosure of total interest expense (using the effective interest method) for financial liabilities that are not at fair value through profit or loss. This section does not require any additional disclosure.

Section 26 *Share-based Payment*

Disclosures

26.18	An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period: (a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (for example whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information. (b) the number and weighted average exercise prices of share options for each of the following groups of options: (i) outstanding at the beginning of the period; (ii) granted during the period; (iii) forfeited during the period; (iv) exercised during the period; (v) expired during the period; (vi) outstanding at the end of the period; and (vii) exercisable at the end of the period.
26.19	For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.
26.20	For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.
26.21	For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.
26.22	If the entity is part of a group share-based payment plan, and it measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).
26.23	An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position: (a) the total expense recognised in profit or loss for the period; and (b) the total carrying amount at the end of the period for liabilities arising from share-based payment transactions.

Section 27 *Impairment of Assets*

Disclosures

27.32	An entity shall disclose the following for each class of assets indicated in paragraph 27.33: (a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are included; and (b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are reversed.
27.33	An entity shall disclose the information required by paragraph 27.32 for each of the following classes of asset: (a) inventories; (b) property, plant and equipment (including investment property accounted for by the cost method); (c) goodwill; (d) intangible assets other than goodwill; (e) investments in associates; and (f) investments in joint ventures.

Section 28 *Employee Benefits*

Disclosures about short-term employee benefits

28.39	This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

28.40	An entity shall disclose the amount recognised in profit or loss as an expense for defined contribution plans. If an entity treats a defined benefit multi-employer plan as a defined contribution plan because sufficient information is not available to use defined benefit accounting (see paragraph 28.11) it shall disclose the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan's surplus or deficit and the implications, if any, for the entity.

Disclosures about defined benefit plans

28.41	An entity shall disclose the following information about defined benefit plans (except for any defined multi-employer benefit plans that are accounted for as a defined contribution plans in accordance with paragraph 28.11, for which the disclosures in paragraph 28.40 apply instead). If an entity has more than one defined benefit plan, these disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful: (a) a general description of the type of plan, including funding policy; (b) the entity's accounting policy for recognising actuarial gains and losses (either in profit or loss or as an item of other comprehensive income) and the amount of actuarial gains and losses recognised during the period; (c) if the entity uses any of the simplifications in paragraph 28.19 in measuring its defined benefit obligation, it shall disclose that fact and the reasons why using the projected unit credit method to measure its obligation and cost under defined benefit plans would involve undue cost or effort; (d) the date of the most recent comprehensive actuarial valuation and, if it was not as of the reporting date, a description of the adjustments that were made to measure the defined benefit obligation at the reporting date; (e) a reconciliation of opening and closing balances of the defined benefit obligation showing separately benefits paid and all other changes; (f) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, if applicable: (i) contributions; (ii) benefits paid; and (iii) other changes in plan assets. (g) the total cost relating to defined benefit plans for the period, disclosing separately the amounts: (i) recognised in profit or loss as an expense; and (ii) included in the cost of an asset.

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	(h) for each major class of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major class constitutes of the fair value of the total plan assets at the reporting date; (i) the amounts included in the fair value of plan assets for: (i) each class of the entity's own financial instruments; and (ii) any property occupied by, or other assets used by, the entity. (j) the actual return on plan assets; and (k) the principal actuarial assumptions used, including, when applicable: (i) the discount rates; (ii) the expected rates of return on any plan assets for the periods presented in the financial statements; (iii) the expected rates of salary increases; (iv) medical cost trend rates; and (v) any other material actuarial assumptions used. The reconciliations in (e) and (f) need not be presented for prior periods. A subsidiary that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group (see paragraph 28.38) shall, in its separate financial statements, describe its policy for making the allocation and shall make the disclosures in (a)—(k) above for the plan as a whole.

Disclosures about other long-term benefits

28.42	For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of funding at the reporting date.

Disclosures about termination benefits

28.43	For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of funding at the reporting date.
28.44	When there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Section 21 *Provisions and Contingencies* requires an entity to disclose information about its contingent liabilities unless the possibility of an outflow in settlement is remote.

Section 29 *Income Tax*

Current and non-current

29.36	When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify any deferred tax assets (liabilities) as current assets (liabilities).

Offsetting

29.37	An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities, if, and only if, it has a legally enforceable right to set off the amounts and the entity can demonstrate without undue cost or effort that it plans either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Disclosures

29.38	An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events.
29.39	An entity shall disclose separately the major components of tax expense (income). Such 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; (c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences; (d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes; (e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce tax expense; (f) adjustments to deferred tax expense (income) arising from a change in the tax status of the entity or its shareholders; (g) deferred tax expense (income) arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 29.31; and (h) the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with Section 10 *Accounting Policies, Estimates and Errors*, because they cannot be accounted for retrospectively.

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29.40	An entity shall disclose the following separately: (a) the aggregate current and deferred tax relating to items that are recognised as items of other comprehensive income. (b) the aggregate current and deferred tax relating to items that are charged or credited directly to equity. (c) an explanation of any significant differences between the tax expense (income) and accounting profit multiplied by the applicable tax rate. For example such differences may arise from transactions such as revenue that are exempt from taxation or expenses that are not deductible in determining taxable profit (tax loss). (d) an explanation of changes in the applicable tax rate(s) compared with the previous reporting period. (e) for each type of temporary difference and for each type of unused tax losses and tax credits: (i) the amount of deferred tax liabilities and deferred tax assets at the end of the reporting period; and (ii) an analysis of the change in deferred tax liabilities and deferred tax assets during the period. (f) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the statement of financial position. (g) in the circumstances described in paragraph 29.33, an explanation of the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.
29.41	If an entity does not offset tax assets and liabilities in accordance with paragraph 29.37 because it is unable to demonstrate without undue cost or effort that it plans to settle them on a net basis or realise them simultaneously, the entity shall disclose the amounts that have not been offset and the reasons why applying the requirement would involve undue cost or effort.

Section 30 *Foreign Currency Translation*

Disclosures

30.24	In paragraphs 30.26 and 30.27, references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.
30.25	An entity shall disclose the following: (a) the amount of exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss in accordance with Section 11 *Basic Financial Instruments* and Section12 *Other Financial Instrument Issues*; and. (b) the amount of exchange differences arising during the period and classified in a separate component of equity at the end of the period.
30.26	An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.
30.27	When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

Section 31 *Hyperinflation*

Disclosures

31.15	An entity to which this section applies shall disclose the following: (a) the fact that financial statements and other prior period data have been restated for changes in the general purchasing power of the functional currency; (b) the identity and level of the price index at the reporting date and changes during the current reporting period and the previous reporting period; and (c) amount of gain or loss on monetary items.

Section 32 *Events after the End of the Reporting Period*

Date of authorisation for issue

32.9	An entity shall 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 issue, the entity shall disclose that fact.

Non-adjusting events after the end of the reporting period

32.10	An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period: (a) the nature of the event; and (b) an estimate of its financial effect or a statement that such an estimate cannot be made.
32.11	The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure; the disclosures will reflect information that becomes known after the end of the reporting period but before the financial statements are authorised for issue: (a) a major business combination or disposal of a major subsidiary; (b) announcement of a plan to discontinue an operation; (c) major purchases of assets, disposals or plans to dispose of assets, or expropriation of major assets by government; (d) the destruction of a major production plant by a fire; (e) announcement, or commencement of the implementation, of a major restructuring; (f) issues or repurchases of an entity's debt or equity instruments; (g) abnormally large changes in asset prices or foreign exchange rates; (h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities; (i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and (j) commencement of major litigation arising solely out of events that occurred after the end of the reporting period.

Section 33 *Related Party Disclosures*

Disclosure of parent-subsidiary relationships

33.5	Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been related party transactions. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

33.7	An entity shall disclose key management personnel compensation in total.

Disclosure of related party transactions

33.8	A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged. Examples of related party transactions that are common to SMEs include, but are not limited to: (a) transactions between an entity and its principal owner(s); (b) transactions between an entity and another entity when both entities are under the common control of a single entity or person; and (c) transactions in which an entity or person that controls the reporting entity incurs expenses directly that otherwise would have been borne by the reporting entity.
33.9	If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall 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 uncollectible receivables 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. Such transactions could include purchases, sales, or transfers of goods or services; leases; guarantees; and settlements by the entity on behalf of the related party or vice versa.
33.10	An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories: (a) entities with control, joint control or significant influence over the entity; (b) entities over which the entity has control, joint control or significant influence; (c) key management personnel of the entity or its parent (in the aggregate); and (d) other related parties.
33.11	An entity is exempt from the disclosure requirements of paragraph 33.9 in relation to: (a) a state (a national, regional or local government) that has control, joint control or significant influence over the reporting entity; and (b) another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity. However, the entity must still disclose a parent-subsidiary relationship as required by paragraph 33.5.
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33.12	The following are examples of transactions that shall be disclosed if they are with a related party: (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; (i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party; and (j) participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities.
33.13	An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.
33.14	An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Section 34 *Specialised Activities*

Agriculture disclosures – fair value model

34.7	An entity shall disclose the following with respect to its biological assets measured at fair value: (a) a description of each class of its biological assets. (b) the methods and significant assumptions applied in determining the fair value of each class of agricultural produce at the point of harvest and each class of biological assets. (c) a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include: (i) the gain or loss arising from changes in fair value less costs to sell; (ii) increases resulting from purchases; (iii) decreases resulting from harvest; (iv) increases resulting from business combinations; (v) net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and (vi) other changes. This reconciliation need not be presented for prior periods.

Agriculture disclosures – cost model

34.10	An entity shall disclose the following with respect to its biological assets measured using the cost model: (a) a description of each class of its biological assets; (b) an explanation of why fair value cannot be measured reliably without undue cost or effort; (c) the depreciation method used; (d) the useful lives or the depreciation rates used; and (e) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

Exploration for and evaluation of mineral resources

34.11C	Exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. An entity shall measure, present and disclose any resulting impairment loss in accordance with Section 27 *Impairment of Assets*, except as provided by paragraph 34.11F.

Service concession arrangements – operating revenue

34.16	The operator of a service concession arrangement shall recognise, measure and disclose revenue in accordance with Section 23 *Revenue* for the services it performs.

Section 35 *Transition to the* IFRS for SMEs

Scope of this section

35.2	An entity that has applied the *IFRS for SMEs* in a previous reporting period, but whose most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with the *IFRS for SMEs*, must either apply this section or apply the *IFRS for SMEs* retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors* as if the entity had never stopped applying the *IFRS for SMEs*. When such an entity does not elect to apply this section, it is still required to apply the disclosure requirements in paragraph 35.12A in addition to the disclosure requirements in Section 10.

Procedures for preparing financial statements at the date of transition

35.11	If it is impracticable for an entity to make one or more of the adjustments required by paragraph 35.7 at the date of transition, the entity shall apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify which amounts in the financial statements have not been restated. If it is impracticable for an entity to provide any disclosures required by this Standard, including those for comparative periods, the omission shall be disclosed.

Explanation of transition to the *IFRS for SMEs*

35.12	An entity shall explain how the transition from its previous financial reporting framework to this Standard affected its reported financial position, financial performance and cash flows.
35.12A	An entity that has applied the *IFRS for SMEs* in a previous period, as described in paragraph 35.2, shall disclose: (a) the reason it stopped applying the *IFRS for SMEs*; (b) the reason it is resuming the application of the *IFRS for SMEs*; and (c) whether it has applied this section or has applied the *IFRS for SMEs* retrospectively in accordance with Section 10.

Reconciliations

35.13	To comply with paragraph 35.12, an entity's first financial statements prepared using this Standard shall include: (a) a description of the nature of each change in accounting policy; (b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this Standard for both of the following dates: (i) the date of transition to this Standard; and (ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework. (c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this Standard for the same period.
35.14	If an entity becomes aware of errors made under its previous financial reporting framework, the reconciliations required by paragraph 35.13 (b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.
35.15	If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this Standard.

Effective date and transition

A1	Earlier application of 2015 *Amendments to the IFRS for SMEs* is permitted. If an entity applies *2015 Amendments to the IFRS for SMEs* for an earlier period it shall disclose that fact.
A3	The entity shall identify which amounts in the financial statements have not been restated as a result of applying paragraph A2.