- the beginning of the preceding period.

When presented, the date of the third statement of financial position is always at the beginning of the preceding period, regardless of whether the financial statements present comparative information for earlier periods. [HKAS 1:40D]

Prior to the 2009-2011 Improvements, it was not clear whether the third statement of financial position should always be presented at the beginning of the preceding period (i.e. at the beginning of the period for which a statement of comprehensive income is required under HKFRSs) or whether it should be at the beginning of the first period presented in the financial statements (which would be a different date if, for example, an entity presented a third statement of comprehensive income in accordance with the requirements of a regulator). Paragraph 40D provides clarification in this respect.

2.10.4.1 *What is meant by a 'reclassification' in the context of the requirement for a third statement of financial position?*

It appears that the phrase 'reclassifies items in its financial statements' in HKAS 1:40A (or, prior to the 2009-2011 Improvements, in HKAS 1:39) is intended to capture the types of 'reclassification' described in HKAS 1:41 (see **section 2.10.5** below). In stating that the third statement of financial position is only required if it is materially affected by the reclassification, 1:40A is clear that the following prospective event-driven reclassifications, for example, are not captured, because they do not affect the third statement of financial position:

- reclassification of an asset or liability from non-current to current under HKAS 1 because of the passage of time;
- for entities applying HKAS 39 *Financial Instruments: Recognition and Measurement*, reclassification of a financial asset from the held-to-maturity to the available-for-sale category and vice versa;
- for entities applying HKAS 39, reclassification of cumulative gains or losses on an available-for-sale financial asset from equity to profit or loss as a reclassification adjustment on impairment or disposal of the asset;
- classification of an operation as discontinued with reclassification of the comparative period statement of comprehensive income; and
- reclassification of a property from inventories to investment property on commencement of an operating lease to another party.

2.10.4.2 *Application of the requirement for a third statement of financial position to regulatory filings*

Example 2.10.4.2

Application of the requirement for a third statement of financial position to regulatory filings

Entity A with a calendar year end prepares its financial statements in accordance with HKFRSs. Entity A's securities are listed on a regulated exchange which requires two statements of financial position and three statements of comprehensive income and cash flows to be presented in the financial statements.

Scenario 1

In its 20X8 financial statements, Entity A has not applied an accounting policy retrospectively or made a retrospective restatement or reclassification requiring the presentation of a third statement of financial position at the beginning of the preceding period (i.e. as at 1 January 20X7) under HKAS 1:40A.

As required by its regulator, Entity A presents statements of comprehensive income and cash flows for each of the years ending 31 December 20X8, 20X7 and 20X6.

Entity A is not required to present three statements of financial position. The third statements of comprehensive income and cash flows presented in respect of the earliest comparative period are supplementary information for regulatory purposes only. As clarified in HKAS 1:38C (see **section 2.10.3** above), Entity A is only required under HKAS 1:38 and 38A to present one year of comparative information for its 20X8 statement of financial position.

Scenario 2

In its 20X9 financial statements, Entity A makes a retrospective restatement that materially affects the statement of financial position at 1 January 20X8. As a result, HKAS 1:40A requires the presentation of an additional statement of financial position at the beginning of the preceding period (i.e. at 1 January 20X8). For regulatory purposes, Entity A also presents the third statements of comprehensive income and cash flows for the year ended 31 December 20X7.

Entity A is not required to present a fourth statement of financial position at 1 January 20X7. As clarified by HKAS 1:40D (see **section 2.10.4** above), the additional statement of financial position is only required at the beginning of the preceding period (in this example, 20X8), not at the beginning of the earliest period presented (in this example, 20X7). It is acceptable for Entity A to present four statements of financial position if it chooses to do so, but this is not required.

2.10.4.3 *Note disclosures required to support an additional statement of financial position*

When an entity is required to present an additional statement of financial position as at the beginning of the preceding period in accordance with HKAS 1:40A, it need not present notes supporting that opening statement of financial position. [HKAS 1:40C]

However, in the circumstances when an additional statement of position is required to be presented, the entity is required to disclose the information required by HKAS 1:41

Guidance on the meaning of 'substantially the full term' is provided in the **example 10.1.2A**.

Example 10.1.2A

Determining how an input is classified when the item being measured has a specified contractual term

Company X enters into a fixed-price six-year agreement to sell 50 megawatts (MW) of on-peak electricity for delivery at location ABC beginning on 1 January 20X1 and continuing through to 31 December 20X6. On 31 March 20X1, Company X is measuring the fair value of the fixed-price agreement. Active market quotes are available for forward contracts to sell electricity at location ABC for two years (31 March 20X1 to 31 March 20X3). Accordingly, Company X will use the two years of observable forward pricing data and develop an expectation for the remaining 3 years and nine months (i.e. 1 April 20X3 to 31 December 20X6) using a model that relies on pricing data and weather patterns from the previous four years. The model also incorporates all relevant physical constraints (capacity of existing power plants and power plants expected to be completed near location ABC, projected supply and demand etc.).

In the circumstances described, the five-year and nine-month forward price curve represents a Level 3, rather than a Level 2, input.

An input for an item with a specified contractual term falls within Level 2 of the hierarchy only if it meets both of the following criteria:

- as required by HKFRS 13:82 (see above), the input must be observable for substantially the full term of the asset or liability; and
- the impact of the unobservable period must not be significant to the fair value of the asset or liability. The guidance set out in **section 10.2.2.1** below should be applied when evaluating whether the effect of the unobservable period is significant.

HKFRS 13:B35(b) cites as an example an interest rate swap with a term of 10 years and for which the fair value is determined using a swap rate based on a yield curve that is observable at commonly quoted intervals for 9 years. The swap rate input is a Level 2 input provided that any reasonable extrapolation of the yield curve for Year 10 would not be significant to the fair value measurement of the swap in its entirety.

In contrast, in the circumstances described, Company X can observe forward prices for only 24 months of the remaining 69-month term of the agreement (i.e. 35 per cent of the term). Because this does not represent substantially the full term, the first criterion above is not met. An analysis of the second criterion is unnecessary; the forward price curve is considered a Level 3 input. However, if the forward price curve had been observable for substantially the full term, Company X would need to consider the second criterion (i.e. whether the effect of the unobservable term is significant to the fair value of the agreement) to determine whether the forward price curve is a Level 2 or Level 3 input.

Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

[HKFRS 13:83]

- the condition or location of the asset;

- the extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in HKFRS 13:39 – see **section 5.1.1** above); and
- the volume or level of activity in the markets within which the inputs are observed.

An entity should consider whether adjustments to the quoted price for a similar asset or liability are necessary to reflect differences between the terms of the items being compared and other factors that may affect the fair values of those items. For example, the entity may need to make adjustments to reflect differences in the condition, location or risks (including non-performance risk and liquidity risk) of the items being compared.

Under HKFRS 13:37, an entity should measure the fair value of a liability by reference to the quoted price of a similar item that is held by another party as an asset. In such circumstances, the quoted price of the similar item held by another party as an asset should be adjusted for factors specific to the asset that are not applicable to the fair value measurement of the liability. HKFRS 13:39 provides a number of examples of such factors (see **section 5.1.1** above).

In addition, if an entity uses a quoted price for a similar item in its valuation technique, the entity may need to make adjustments to reflect differences in risk, including liquidity differences. For example, the item being measured may be in shorter supply (relative to demand) than the similar item for which a quoted price exists. In this situation, a liquidity risk premium exists for the item being measured that should be factored into the fair value measurement as an adjustment to the quoted price of the similar item.

Example 10.1.2B provides an illustration of circumstances in which the quoted price for a similar asset needs to be adjusted to reflect the different characteristics of the asset being measured.

Example 10.1.2B

Using quoted prices for a similar asset or liability

Sales of genetically modified wheat are increasing globally. However, there are no separate markets for genetically modified wheat and wheat that is not genetically modified. Thus, when measuring their agricultural produce at the time of harvest at fair value less costs to sell under HKAS 41 *Agriculture*, sellers of genetically modified wheat use quoted prices for wheat that is not genetically modified. Because the quoted price is for a similar asset, that price would generally represent a Level 2 input. However, because genetically modified wheat has different characteristics to the wheat for which a quoted price exists, an adjustment should be made to reflect market participant assumptions about the price that would be received for selling genetically modified wheat. If the adjustment is significant to the entire measurement and based on unobservable data, the entire measurement would be classified as a Level 3 measurement.

An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorised within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs. [HKFRS 13:84] See **section 10.2.2.1** for further discussion.

HKFRS 13 provides the following examples of Level 2 inputs for particular assets and liabilities.

[HKFRS 13:B35]

- **Receive-fixed, pay-variable interest rate swap based on the London Interbank Offered Rate (LIBOR) swap rate** A Level 2 input would be the LIBOR swap rate if that rate is observable at commonly quoted intervals for substantially the full term of the swap.
- **Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency** A Level 2 input would be the swap rate based on a yield curve denominated in a foreign currency that is observable at commonly quoted intervals for substantially the full term of the swap. That would be the case if the term of the swap is 10 years and that rate is observable at commonly quoted intervals for 9 years, provided that any reasonable extrapolation of the yield curve for year 10 would not be significant to the fair value measurement of the swap in its entirety (but see **example 10.1.2A** above for circumstances when observable data is not available for substantially the full term of the agreement).
- **Receive-fixed, pay-variable interest rate swap based on a specific bank's prime rate** A Level 2 input would be the bank's prime rate derived through extrapolation if the extrapolated values are corroborated by observable market data, e.g. by correlation with an interest rate that is observable over substantially the full term of the swap.
- **Three-year option on exchange-traded shares** A Level 2 input would be the implied volatility for the shares derived through extrapolation to year 3 if both of the following conditions exist:
  - prices for one-year and two-year options on the shares are observable; and
  - the extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option.

  In that case, the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.
- **Licensing arrangement** For a licensing arrangement that is acquired in a business combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate of the contract with the unrelated party at inception of the arrangement.
- **Finished goods inventory at a retail outlet** For finished goods inventory that is acquired in a business combination, a Level 2 input would be either a price to customers in a retail market or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (i.e. similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.
- **Building held and used** A Level 2 input would be the price per square metre for the building (a valuation multiple) derived from observable market data, e.g. multiples derived from prices in observed transactions involving comparable (i.e. similar) buildings in similar locations.
- **Cash-generating unit** A Level 2 input would be a valuation multiple (e.g. a multiple of earnings or revenue or a similar performance measure) derived from observable market data, e.g. multiples derived from prices in observed transactions involving comparable (i.e. similar) businesses, taking into account operational, market, financial and non-financial factors.

10.1.3 Level 3 inputs

Level 3 inputs are unobservable inputs for the asset or liability. [HKFRS 13:86 & Appendix A]

Unobservable inputs should be used to measure fair value to the extent that relevant observable inputs are not available (e.g. when there is little, if any, market activity for the asset or liability at the measurement date). However, unobservable inputs should reflect the assumptions that market participants would use when pricing the asset or liability, so as to achieve the general fair value measurement objective (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). [HKFRS 13:87]

Unobservable inputs should reflect, among others, assumptions that market participants would make about risk. Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (e.g. when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability (or similar assets or liabilities) and the entity has determined that the transaction price or quoted price does not represent fair value – see **sections 9.4** to **9.6** above). [HKFRS 13:88]

Unobservable inputs should be developed using the best information available in the circumstances, which might include an entity's own data. In developing unobservable inputs, an entity's own data should be adjusted if reasonably available information indicates that other market participants would use different data or there is something

3.8 Materiality

HKAS 34:23 states that, in deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data. In making assessments of materiality, it should be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.

While materiality judgements are always subjective, the overriding concern is to ensure that an interim financial report includes all of the information that is relevant to understanding the financial position and performance of the entity during the interim period. Therefore, it is generally inappropriate to base quantitative estimates of materiality on projected annual figures.

3.9 Disclosure in annual financial statements

It is quite common that entities do not prepare a separate report for the final interim period in a financial year. This will be determined on the basis of the rules of local regulators. For example, an entity with a reporting period to 31 December, which reports half-yearly, may not be required to produce a separate interim report covering the period from July to December.

In such circumstances, HKAS 34 requires disclosure in the notes to the *annual* financial statements if an estimate of an amount reported in an earlier interim period is changed significantly during the final interim period. The nature and amount of that change in estimate are required to be disclosed. [HKAS 34:26] This requirement is intended to provide the user of the financial statements with details of changes in estimates in the final interim period consistent with those generally required by HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Standard does state, however, that this disclosure requirement is intended to be narrow in scope, relating only to the change in estimate, and it is not intended to introduce a general requirement to include additional interim period financial information in the entity's annual financial statements. [HKAS 34:27]

> HKAS 34:27 makes clear that, when such a change in estimate occurs and is required to be disclosed in the annual financial statements, the disclosure represents additional interim period financial information. Consequently, although the disclosure is made in the annual financial statements, materiality will generally be determined by reference to interim period financial data.

4 Accounting policies

4.1 Same accounting policies as annual financial statements

The accounting policies applied in the interim financial statements should be consistent with those applied in the most recent annual financial statements, except for accounting policy changes made after the date of the most recent annual financial

statements that are to be reflected in the next annual financial statements. [HKAS 34:28]

Entities are required to disclose in their interim financial reports that this requirement has been met. [HKAS 34:16A(a)]

4.2 Changes in accounting policies

Preparers of interim financial reports in compliance with HKAS 34 are required to consider any changes in accounting policies that will be applied for the next annual financial statements, and to implement the changes for interim reporting purposes. Such changes will generally encompass:

- changes required by an HKFRS that will be effective for the annual financial statements; and
- changes that are proposed to be adopted for the annual financial statements, in accordance with the requirements of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, on the basis that they will result in the financial statements providing reliable and more relevant information.

If there has been any change in the entity's accounting policies since the most recent annual financial statements, the interim financial report is required to include a description of the nature and effect of the change. [HKAS 34:16A(a)]

> If a new Standard or Interpretation has been published during the first interim period but it is not effective until after the end of the annual reporting period, an entity may decide in the second interim period to adopt this Standard or Interpretation early for its annual financial statements. The fact that the new Standard or Interpretation was not adopted in its first interim period financial statements does not generally preclude the entity from adopting a new policy in the second interim period or at the end of the annual reporting period. The requirements for restating previously reported interim periods are discussed in **section 4.3**.

Example 4.2

Adoption of new Standard part-way through a financial year

Company X prepares its financial statements in accordance with HKFRSs and has a December year end. It also prepares interim financial reports in accordance with HKAS 34 on a quarterly basis.

The HKICPA issues a new Standard that is effective "for annual periods beginning on or after 1 July 20X3", with earlier adoption permitted. The Standard does not include any specific transition provisions so that, in accordance with HKAS 8:19(b), it is required to be applied retrospectively.

Is Company X required to adopt this Standard in its interim financial report for the three months ending 30 September 20X3?

No. Company X's first annual period beginning on or after 1 July 20X3 is the period from 1 January 20X4 to 31 December 20X4. Company X is not required to adopt the new Standard in interim financial reports relating to interim periods beginning before 1 January 20X4. This is true irrespective of whether Company X's interim financial reports contain a set of condensed financial statements or a complete set of financial statements.

However, if Company X decides to adopt the new Standard in advance of its effective date (e.g. in its annual financial statements to 31 December 20X3), then Company X should apply the new Standard for interim periods beginning on or after that earlier date of adoption (see also the discussion in **section 4.3** on restatement of prior interim periods).

4.3 Restatement of previously reported interim periods

A change in accounting policy, other than one for which the transition provisions are specified by a new HKFRS, should be reflected by:

[HKAS 34:43]

- restating the financial statements of prior interim periods of the current financial year, and the comparable interim periods of prior financial years that will be restated in annual financial statements in accordance with HKAS 8; or
- when it is impracticable to determine the cumulative effect at the beginning of the financial year of applying a new accounting policy to all prior periods, adjusting the financial statements of prior interim periods of the current financial year, and comparable interim periods of prior financial years, to apply the new accounting policy prospectively from the earliest date practicable.

HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application of a new accounting policy is impracticable when an entity cannot apply it after making every reasonable effort to do so.

HKAS 34:44 states that an objective of these principles is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. That is not to say that voluntary changes in accounting policy part-way through the year are prohibited. Such changes are permitted, provided that the conditions of HKAS 8 are met. What HKAS 34:44 requires is that, when a change in accounting policy is adopted at some point during the year, the amounts reported for earlier interim periods should be restated to reflect the new policy.

HKAS 34:45 explains that allowing accounting changes to be reflected as of an interim date within the financial year would allow two differing accounting policies to be applied to a particular class of transactions within a single financial year. This would result in interim allocation difficulties, obscured operating results, and complicated analysis and understandability of interim period information.

Example 4.3

Changes in accounting policies part-way through a financial year

Company A reports quarterly. In its first quarter interim report for the current year, it used the same accounting policies as in its latest annual financial statements. Company A wants to make a voluntary change in accounting policy starting in its second quarter interim report. It can demonstrate that the change "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" as required by HKAS 8:14.

Company A is permitted to make this change in accounting policy in its second quarter interim report provided that the conditions of HKAS 8 are met. HKAS 34:44 requires that the interim financial statements for the first quarter of the year be restated to reflect the new accounting policy adopted in the second quarter. As HKAS 34:45 suggests, what is prohibited is allowing accounting changes to be reflected *as of* an interim date within a financial year. Accounting changes can be made at an interim date within a financial year, with retrospective application to earlier interim periods of that year.

5 Recognition and measurement

5.1 General principles

As discussed in **section 4.1** above, in preparing their interim financial reports, entities are required to apply the same accounting policies as will be applicable for their next annual financial statements. The principles for recognising assets, liabilities, income and expenses for interim periods are the same as in annual financial statements.

It is not intended, however, that each interim period should be seen to stand alone as an independent period. The Standard states that the frequency of an entity's reporting (annual, half-yearly or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes are made on a year-to-date basis. [HKAS 34:28]

There is a degree of inconsistency in HKAS 34. The requirement set out in **section 4.1** above (that the same accounting policies should be applied in the interim financial statements as are applied in annual financial statements) represents a 'discrete period' approach to interim reporting. On the other hand, HKAS 34:28's requirement that measurements for interim reporting purposes should be made on a year-to-date basis so that the frequency of the entity's reporting does not affect the measurement of its annual results represents an 'integral period' approach.

This inconsistency has led to a number of areas of potential conflict between the requirements of HKAS 34 and those of other Standards applied at the end of interim reporting periods. HK(IFRIC) – Int 10 deals with one area of conflict regarding reversals of certain impairment losses (see **section 5.6.16.1** below).

5.2 Seasonal, cyclical or occasional revenues

Revenues that are received seasonally, cyclically or occasionally within a financial year should not be anticipated or deferred as of an interim date, if anticipation or deferral would not be appropriate at the end of the financial year. [HKAS 34:37]

Thus, for example, an entity engaged in retailing does not divide forecasted revenue by two to arrive at its half-year revenue figures. Instead, it reports its

In June 2011, HKFRS 13 *Fair Value Measurement* was issued and is effective for annual periods beginning on or after 1 January 2013 with earlier adoption permitted (see **chapter A6**). HKFRS 13 establishes a single framework for measuring fair value when that is required by other Standards. When an entity applies HKFRS 13, it should measure fair value by reference to the requirements of HKFRS 13.

When HKFRS 13 is first adopted, it is required to be applied prospectively and it need not be applied to comparative information provided for periods before the initial application of the Standard; therefore, amounts reported in prior annual periods are not required to be restated.

When plan investments are held for which an estimate of fair value is not possible, disclosure is required of the reason why fair value is not used. [HKAS 26:32]

For marketable securities, fair value is usually market value because this is considered the most useful measure of the securities at the report date and of the investment performance for the period. [HKAS 26:33]

Those securities that have a fixed redemption value and that have been acquired to match the obligations of the plan, or specific parts thereof, may be carried at amounts based on their ultimate redemption value assuming a constant rate of return to maturity. [HKAS 26:33]

The measurement basis described above appears broadly consistent with the amortised cost model used in HKAS 39 *Financial Instruments: Recognition and Measurement*. But it is not immediately clear how such a basis, which uses a historical rate of return, corresponds to 'fair value', as required by HKAS 26:32.

When plan investments are held for which an estimate of fair value is not possible, such as total ownership of an entity, disclosure is made of the reason why fair value is not used. [HKAS 26:33]

To the extent that investments are carried at amounts other than market value or fair value, fair value is generally also disclosed. [HKAS 26:33]

Assets used in the operations of the fund are accounted for in accordance with applicable HKFRSs. [HKAS 26:33]

6 Disclosure – all plans

The financial statements of a retirement benefit plan, whether defined benefit or defined contribution, should also contain the following information: [HKAS 26:34]

- a statement of changes in net assets available for benefits;
- a summary of significant accounting policies; and

- a description of the plan and the effect of any changes in the plan during the period.

The financial statements provided by retirement benefit plans should include the following, if applicable:

[HKAS 26:35]

- a statement of net assets available for benefits disclosing:
  - assets at the end of the period suitably classified;
  - the basis of valuation of assets;
  - details of any single investment exceeding either 5 per cent of the net assets available for benefits or 5 per cent of any class or type of security;
  - details of any investment in the employer; and
  - liabilities other than the actuarial present value of promised retirement benefits;
- a statement of changes in net assets available for benefits showing the following:
  - employer contributions;
  - employee contributions;
  - investment income such as interest and dividends;
  - other income;
  - benefits paid or payable (analysed, for example, as retirement, death and disability benefits, and lump sum payments);
  - administrative expenses;
  - other expenses;
  - taxes on income;
  - profits and losses on disposal of investments and changes in value of investments; and
  - transfers from and to other plans;
- a description of the funding policy;
- for defined benefit plans, the actuarial present value of promised retirement benefits (which may distinguish between vested benefits and non-vested benefits) based on the benefits promised under the terms of the plan, on service rendered to date and using either current salary levels or projected salary levels. This information may be included in an accompanying actuarial report to be read in conjunction with the related financial statements; and
- for defined benefit plans, a description of the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits.

The report of a retirement benefit plan should contain a description of the plan, either as part of the financial information or in a separate report. It may contain the following: [HKAS 26:36]

- the names of the employers and the employee groups covered;
- the number of participants receiving benefits and the number of other participants, classified as appropriate;
- the type of plan – defined contribution or defined benefit;
- a note as to whether participants contribute to the plan;
- a description of the retirement benefits promised to participants;
- a description of any plan termination terms; and
- changes in the preceding items during the period covered by the report.

In order to provide the required description of the plan, it is acceptable for the entity to refer to other documents that are readily available to users and in which the plan is described, and to include only information on subsequent changes. [HKAS 26:36]

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amortised cost of the host debt instrument. At the date of reclassification, an entity will be required to make the embedded derivative assessment it would have made had the debt instrument not been initially classified as at FVTPL, i.e. the entity will need to determine the instrument's amortised cost for all dates when the instrument may be put, called, or prepaid and compare the amortised cost with the exercise price of the option on those dates.

4.3 Into AFS investments

A debt or equity instrument may be reclassified out of held for trading (part of the FVTPL category) into AFS in accordance with HKAS 39:50 (see **section 4.2** above). Because the instrument is measured at fair value both before and after reclassification, there is no gain/loss on reclassification and all amounts previously recognised in profit or loss prior to the date of reclassification are retained in profit or loss.

An entity must reclassify a debt instrument from HTM to AFS if there is no longer the intention and ability to hold the debt instrument to maturity. Also, all debt instruments must be reclassified out of HTM into AFS when there are sales or reclassifications of more than an insignificant amount of HTM investments that do not meet any of the conditions in HKAS 39:9 (see **section 4.6** below). At the date of reclassification, the difference between the carrying amount of such investments and their fair value should be recognised in other comprehensive income. [HKAS 39:52]

If the fair value of an investment in an unquoted equity instrument becomes sufficiently reliable following a period during which the investment was measured at cost in accordance with HKAS 39:53, resulting in the measurement of that investment at fair value, this is not a reclassification between financial asset categories. Investments in equity instruments can only ever be classified in either FVTPL or AFS (both of which are required to be measured at fair value) and HKAS 39 does not have a fifth classification category. Therefore, although HKAS 39:53 refers to financial assets that became reliably measurable when the measure was not previously available and this paragraph is included in the section titled 'Reclassifications', it is not apparent what category such assets could be reclassified to. It is reasonable to consider such assets as continuing to belong to the same classification category to which they were originally classified, but that their basis of measurement has been changed to fair value. The difference between cost and fair value at the date the fair value becomes reliably measureable should be recognised in other comprehensive income if the asset is classified as an AFS asset (see **sections 4.10** and **4.11** below).

4.4 Out of AFS investments

Investments in debt instruments may be reclassified out of AFS. Investments in equity instruments classified as AFS cannot be reclassified.

If the fair value of an investment in an unquoted equity instrument classified as an AFS asset becomes unreliable and, therefore, an entity ceases to measure this investment at fair value and begins to measure it at cost in accordance with HKAS 39:54, this is not a reclassification between financial asset categories. Investments in equity instruments can only ever be classified in either FVTPL or AFS (both of which require measurement at fair value) and HKAS 39 does not have a fifth classification category. Therefore, although HKAS 39:54 refers to examples where the fair value of an investment in an unquoted equity instrument becomes unreliable, and this paragraph is included in the section of the Standard titled 'Reclassifications', it is not apparent what category such assets could be reclassified to. It is reasonable to consider such assets as continuing to belong to the same classification category to which they were originally classified, but that their basis of measurement has been changed to cost (see **sections 4.10** and **4.11** below).

A financial asset classified as AFS may be reclassified to HTM if the entity has the intent and ability to hold the asset to maturity. The asset may be reclassified during the instrument's life except during the two-year tainting period (see **section 3.3** above) if the entity has disposed of more than an insignificant amount of held-to-maturity assets.

A financial asset classified as AFS may be reclassified out of the AFS category to the loans and receivables category if it meets the definition of loans and receivables and the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

As described in **section 4.2** above, an entity should determine an accounting policy with respect to the date it determines whether a reclassified AFS debt instrument meets the definition of loans and receivables. Two interpretations are acceptable:

(i) assess the definition of loans and receivables at the date of initial recognition of the financial asset; or

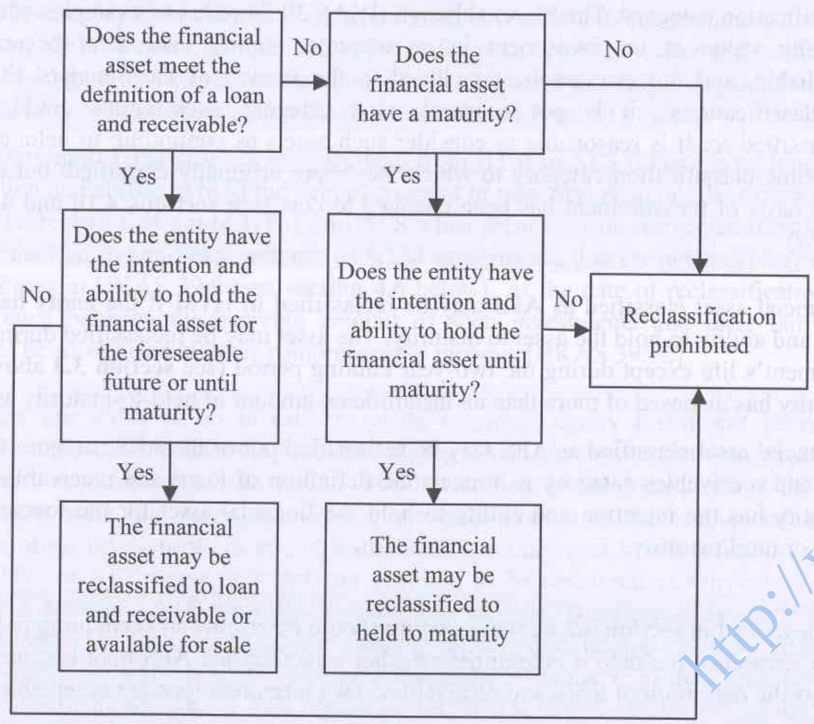
(ii) assess the definition of loans and receivables at the date of reclassification of the financial asset.

An entity should decide on an appropriate interpretation and apply it consistently as an accounting policy choice to all reclassification assessments that require the entity to apply the definition for loans and receivables. If the accounting policy is considered relevant for the understanding of the financial statements, it should be disclosed in accordance with HKAS 1:117.

If an entity's accounting policy is to assess the definition of loans and receivables at the date of initial recognition, then the entity will not be able to reclassify an AFS debt instrument where that AFS debt instrument was classified as such because it did not meet the definition of loans and receivables at initial recognition due to the fact that it was traded in an active market.

If an entity's accounting policy is to assess the definition of loans and receivables at the date of reclassification, then the debt instrument may no longer be traded in an active market and so the entity may be able to reclassify the AFS debt instrument even though it did not meet the definition of loans and receivables at initial recognition.

The following summarises the criteria for reclassifying out of AFS.



A financial asset reclassified from AFS should be reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in profit or loss should not be reversed. The fair value of the financial asset on the date of reclassification becomes its new amortised cost.

Any previous gain or loss on an AFS asset that has been recognised in other comprehensive income should be amortised to profit or loss over the remaining life of the investment using the effective interest method in the case of an instrument with a fixed maturity. Any difference between the new amortised cost (being the asset's fair value at the date of reclassification) and its maturity amount should also be amortised over the remaining life of the financial asset using the effective interest method, similar to the amortisation of a premium or a discount. In the case of a financial asset that does not have a fixed maturity (e.g. a perpetual debt instrument reclassified from

AFS to loans and receivables), the gain or loss should be recognised in profit or loss when the financial asset is sold or otherwise disposed of or impaired. If the reclassified financial asset is subsequently impaired, any previous gain or loss that has been recognised in other comprehensive income is reclassified from equity to profit or loss irrespective of whether or not the asset has a fixed maturity. [HKAS 39:54]

A financial asset reclassified out of AFS to loans and receivables is subject to extensive disclosure requirements (see **section 4.1.4** of **chapter B12**).

4.5 Into HTM investments

A financial asset classified as at FVTPL may be reclassified to HTM if the financial asset is no longer held for the purpose of selling or repurchasing it in the near term [HKAS 39:50(c)] and it meets the definition of a HTM investment. The criteria for reclassification are described in **section 4.2** above.

A financial asset classified as AFS may be reclassified to HTM if the entity has the intent and ability to hold the asset to maturity. The asset may be reclassified during the instrument's life except during the two-year tainting period if the entity has disposed of more than an insignificant amount of HTM assets. When the two-year period subsequent to the period in which tainting occurred has passed, the entity is allowed to reclassify the assets back into HTM provided that it intends and is able to hold these assets to maturity. On the date of reclassification, an asset's carrying amount (i.e. its fair value at the date of reclassification) becomes the asset's new amortised cost. [HKAS 39:54] Any previous fair value gain or loss on the asset that has been accumulated in equity is amortised to profit or loss over the remaining life of the financial asset using the effective interest method.

4.6 Out of HTM investments

When, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as HTM, it is reclassified to AFS and remeasured at fair value. [HKAS 39:51] The 'tainting' provisions of HKAS 39 (see **section 3.3** above) apply not only to sales but also to reclassifications of HTM investments. Therefore, reclassifications of more than an insignificant amount of HTM investments, which do not meet any of the conditions for permitted sales, taint the HTM portfolio and all remaining HTM investments must be reclassified into AFS.

On reclassification out of HTM into the AFS category, as a consequence of tainting, any difference between an asset's carrying amount and its fair value is recognised in other comprehensive income. [HKAS 39:51 and HKAS 39:55(b)] This difference must be disclosed in addition to the reason for reclassification. [HKFRS 7:12]

When an entity taints its HTM portfolio in the current reporting period, and is required to reclassify all of its HTM investments into the AFS category, it does not restate its comparatives for the reporting period to reflect this change of classification, because this would conceal the impact of 'tainting' the portfolio.

9.2 Applying a premium or discount

In some cases, the characteristics of an asset or a liability that market participants would take into account in a transaction for the asset or liability result in the application of an adjustment, such as a premium or discount (e.g. a control premium or non-controlling interest discount). However, a fair value measurement should not incorporate a premium or discount that is inconsistent with the unit of account in the HKFRS that requires or permits the fair value measurement (see **section 3.1** above). [HKFRS 13:69]

Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) are not permitted in a fair value measurement. [HKFRS 13:69]

For example, an investor holding one share that is quoted in an active market may receive a different amount of consideration per share compared to an investor that sells 15 per cent of the total equity shares. The difference between the two holdings is simply the size of the investor's holding, which is typically not a characteristic of the financial asset and thus is not considered in the fair value measurement in this circumstance. For both investors, the fair value measurement of the shares is the price for disposing of a single share multiplied by the quantity held.

In contrast, when measuring the fair value of a controlling interest, it is appropriate to incorporate a control premium because HKFRS 13 regards the control premium as a characteristic of the asset or liability. [HKFRS 13:69]

In all cases, if there is a quoted market price in an active market for an asset or a liability, the entity should use that price without adjustment when measuring fair value, except as specified in HKFRS 13:79 (see **section 10.1.1** below). [HKFRS 13:69]

When measuring the fair value of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk the unit of measurement reflects the portfolio, not the individual units of account that make up the portfolio. In this case the size of the portfolio is a characteristic of that unit of measurement. See **Example 6** above.

9.3 Bid price versus ask price inputs

If an asset or a liability measured at fair value has a bid price and an ask price (e.g. an input from a dealer market), HKFRS 13 requires the price within the bid-ask spread that is most representative of fair value in the circumstances to be used to measure fair value regardless of where the input is categorised within the fair value hierarchy (i.e. Level 1, 2 or 3; see **section 10** below).

HKFRS 13 permits, but does not require, that asset positions may be measured at bid prices and that liability positions may be measured at ask prices. [HKFRS 13:70]

HKFRS 13 allows an entity to use mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. [HKFRS 13:71]

An entity does not need to meet any specific qualifying criteria to use mid-market pricing or other pricing conventions as a practical expedient for measuring fair value, provided that the selected pricing convention:

- is used by market participants (e.g. an industry-accepted pricing convention); and
- is consistent with the fair value measurement objective of HKFRS 13. For example, it would not be appropriate to use ask prices for recognised assets or bid prices for recognised liabilities because such a pricing approach would be inconsistent with the HKFRS 13 objective that fair value is an exit price.

The decision to use a particular pricing convention is an accounting policy choice that should be consistently applied from period to period and for assets or liabilities with similar characteristics and risk. The policy should also be disclosed, if appropriate.

Example 9.3

Mid-market prices

Entity X and Entity Y hold the same debt security as an asset. Entity Y, a broker-dealer, is a market-maker in the debt security. Entity X is not. The debt security is traded in an active market by Entity Y (and other broker-dealers) using bid and ask prices.

Even though Entity X would most likely sell the debt security at or close to the bid price, Entity X may select a policy to use the mid-market price as the fair value of the debt security as a practical expedient. However, it would not be appropriate to use the ask price for the debt security because this would be inconsistent with the objective of fair value being an exit price.

Even though Entity Y may be able to exit at a price greater than the bid price, Entity Y may choose as its policy to measure the debt security by using the bid price as a practical expedient.

HKFRS 13 also contains detailed guidance for circumstances when an entity may fair value a portfolio of similar items together that have offsetting market risks and in doing so use mid-market prices for the offsetting market risks (see **section 6** above).

9.3.1 Changes in the use of bid, ask or mid-market pricing or other pricing conventions

When an entity has in the past complied with the requirements of HKFRS 13:70 (see above) and measured fair value at the price within the bid-ask spread that is most representative of fair value in the circumstances, it is not generally appropriate for the entity to change its accounting policy to using the practical expedient of mid-market pricing or another pricing convention as permitted by HKFRS 13:71.

Once a valuation technique has been selected, it should generally be applied consistently. A change in a valuation technique is only appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. [HKFRS 13:65]

Having established a policy of measuring fair value at the price within the bid-ask spread that is most representative of fair value in the circumstances, a change to using a practical expedient such as mid-market pricing or another pricing convention would generally be inappropriate because it would not typically result in a measurement that is equally or more representative of fair value.

9.4 Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

HKFRS 13 notes that the fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). [HKFRS 13:B37]

The consequence of a significant decrease in the volume or level of activity could be that a transaction price or a quoted price for that item is not representative of fair value. However, a decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. [HKFRS 13:B38]

The following are examples of factors that can help determine whether, on the basis of evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability:

[HKFRS 13:B37]

- there are few recent transactions;
- price quotations are not developed using current information;
- price quotations vary substantially either over time or among market-makers (e.g. some brokered markets);
- indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability;
- there is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability;
- there is a wide bid-ask spread or significant increase in the bid-ask spread;

- there is a significant decline in the activity of, or there is an absence of, a market for new issues (i.e. a primary market) for the asset or liability or similar assets or liabilities; and
- little information is publicly available (e.g. for transactions that take place in a principal-to-principal market).

In assessing whether there has been a significant decrease in the volume or level of activity, an entity should evaluate the significance and relevance of factors such as those listed above. [HKFRS 13:B37]

Note that the presence of one or more of the factors listed in HKFRS 13:B37 alone is not sufficient to conclude that a market is not 'active' (see **section 10.1.1** below for further discussion).

If it is concluded that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. If it is determined that a transaction or quoted price does not represent fair value (e.g. there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if those prices are to be used as a basis for measuring fair value. The adjustment can be significant to the fair value measurement in its entirety. [HKFRS 13:B38]

Adjustments also may be necessary in other circumstances (e.g. when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured, or when the price is 'stale'). [HKFRS 13:B38]

HKFRS 13 does not prescribe a methodology for making significant adjustments to transactions or quoted prices. Consistent with valuation techniques discussed in **section 8** above, appropriate risk adjustments should be applied, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability. Otherwise, the measurement does not faithfully represent fair value. In some cases, determining the appropriate risk adjustment may be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment should be reflective of an orderly transaction between market participants at the measurement date under current market conditions. [HKFRS 13:B39]

If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (e.g. the use of a market approach and an income approach – see **sections 8.1** and **8.3** above, respectively). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity should consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed. [HKFRS 13:B40]

Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair