

## **Technical Note 07/2006 – Key Sources of Estimate Uncertainty**

The use of reasonable estimates is an essential part of the preparation of financial statements and it does not undermine the reliability of financial statements. Estimates may be required in determining:

- (a) revenue from rendering of services;
- (b) the useful lives and the expected pattern of consumption of the future economic benefits embodied in an item of property, plant and equipment;
- (c) the fair value of property, plant and equipment;
- (d) the recoverable amount of intangible assets, goodwill and property, plant and equipment for the purpose of impairment review,
- (e) the fair value of financial assets or financial liabilities where market values are not readily available;
- (f) the amount of impairment of financial assets (including allowance for bad debts);
- (g) the net realisable value of inventory;
- (h) provisions for warranty obligations;
- (i) provisions for post-employment benefit;
- (j) provisions for the uncertain outcome of a litigation in progress; and
- (k) estimated losses on construction contracts in progress.

Paragraph 116 of HKAS 1 “Presentation of Financial Statements” (“Paragraph 116”) requires that an entity should disclose in the notes information about the (i) key assumptions concerning the future, and (ii) other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Disclosures in Paragraph 116 are not required for assets and liabilities that are measured at fair value based on recently observed market prices.

Disclosure for some of the key assumptions concerning the future required by Paragraph 116 may have already been disclosed in accordance with the requirements of other financial reporting standard.

The following table lists out the significant assumptions that should already been made in accordance with other financial reporting standards:

HKAS 16.77(c)	The significant assumptions applied in estimating the fair values of property, plant and equipment (if they are carried at revalued amounts).
HKAS 19.120(h)	The principal actuarial assumptions used in determining the present value of obligations under defined benefit plans.
HKAS 32.92(a)	The significant assumptions applied in determining fair values of financial assets and financial liabilities (separately for significant classes of financial assets and financial liabilities).
HKAS 36.134(d) & (e)	The key assumptions used in determining (i) value in use or (ii) fair value less cost to sell of cash generating unit allocated with goodwill or intangible assets with indefinite useful life.
HKAS 37.85(b)	Major assumptions made concerning future events (where such disclosure are necessary to provide adequate information regarding provisions).
HKAS 38.124(c)	The significant assumptions applied in estimating fair values of intangible assets (if intangible assets are accounted for at revalued amounts).
HKAS 40.75(d)	The significant assumptions applied in determining the fair value of investment property (including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors because of the nature of the property and lack of comparable market data).
HKAS 41.47	The significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets.
HKFRS 2.47(a)(i)	The assumptions made to incorporate the effects of expected early exercise of share options.

Taking into account these disclosures of significant assumptions made in accordance with other financial reporting standards, a sample of disclosure that would comply with the requirements of Paragraph 116 is as follows:

XX*	KEY SOURCES OF ESTIMATION UNCERTAINTY	* Preferably placing this note near the end of the "Notes to Financial Statements".
	<p>In addition to the key assumptions concerning the future disclosed in [Notes xx, xx, xx and xx], other key sources of estimation uncertainty are as follows:</p>	
	<p>(i) trade receivables of [HK\$xxx (2005: HK\$xxx)] due from customers for service rendered at 31 December 2006 were estimated by reference to the stage of completion of transaction determined [by the percentage of services performed to date bear to the total services to be performed] [by reference to the percentage of costs incurred to date bear to the estimated total costs of the transaction] [by surveys of work performed];</p>	HKAS 1.116*
	<p>(ii) property, plant and equipment of [HK\$xxx (2005: HK\$xxx)] at 31 December 2006 were stated at stated at cost [or valuation] less accumulated depreciation and impairment losses. Estimation is made in the determination of the useful lives, residual values and the expected pattern of consumption of the future economic benefits embodied.</p>	HKAS 1.116*
	<p>(iii) trade receivables of [HK\$xxx (2005: HK\$xxx)] at 31 December 2006 were carried at amortised cost, less allowance for impairment. Estimation is made in the determination of the allowance for impairment of HK\$xxx (2005: HK\$xxx) at 31 December 2006.</p>	HKAS 1.116* HKAS 32.94(i)
	<p>(iv) provisions of [HK\$xxx (2005: HK\$xxx)] at 31 December 2006 were made for the uncertain outcome of litigations in progress. Estimation is made in the determination of the amounts of provisions.</p>	HKAS 1.116* HKAS37.84(a)
	<p>(v) provisions of [HK\$xxx (2005: HK\$xxx)] at 31 December 2006 were made for the expected losses of construction contract [service contract] in progress. Estimation is made in the determination of the amounts of provisions.</p>	HKAS 1.116*
	<p>Based on existing knowledge, it is reasonably possible that outcomes within the next financial year that are different from assumptions made could require a material adjustment to the carrying amount of these assets or liabilities.</p>	HKAS 1.112

\* Paragraph 116 requires disclosure of:

- (a) the carrying amounts of assets and liabilities as at the balance sheet date that are subject to estimation uncertainty; and
- (b) their nature.