POSITION PAPER

Accounting treatment of Daily Revenue Contract ("DRC"), Daily Revenue Obligation("DRO") and Daily Revenue Portfolio ("DRP") under International Financial Reporting Standards ("IFRS") and Chinese Accounting Standards ("CAS")

Introduction

The issuance of Daily Revenue Contracts (DRCs) and investment in Daily Revenue Obligations (DROs) and Daily Revenue Portfolios (DRPs) continues to surge in popularity and attract increasing market attention, Micro Connect Group ("**Micro Connect**") has initiated discussions with accounting professionals to explore the appropriate accounting treatment of DRC, DRO and DRP from multiple perspectives under both IFRS and CAS frameworks.

DRC is a contractual agreement entered into between investors and micro or small businesses in which the investors agree to provide funding to the investee for its business operations and the business agrees to share with the investor a percentage of the revenue generated during the contract period.

DRO is a tradable instrument that is registered, and custodied on Micro Connect Macao Financial Assets Exchange ("**MCEX**") and represents economic entitlements to its corresponding DRC. DRC is the underlying asset of DRO, and DRO is a foundational product of MCEX. MCEX is a licensed financial institution approved by an Executive Order signed by the Chief Executive of Macau in December 2022 and regulated by the Monetary Authority of Macau ("AMCM").

To enhance investment opportunities and provide international investors with direct access to the consumer economies of Mainland China, Hong Kong, Macau and other regions, MCEX serves as a 'connector' through its infrastructure – signing DRCs on behalf of international investors through its subsidiaries in Mainland China and Hong Kong with the businesses, while issuing DROs that grant the economic entitlement and rights associated with the corresponding DRCs to the investors.

In this sense, micro and small businesses that come to MCEX to raise funds are DRC issuers and are the "sellers" ("Store Issuers"). Investors who are certified by MCEX and subscribe to DROs to provide funding are known as the "buyers" ("DRO Investors").

DRP represents a basket of DROs, which is a collection of DROs assembled according to specific investment guidelines, criterias, structures and themes. The issuer of a DRP ("**DRP** Issuer") shall be a qualified member of the exchange that holds DRO. DRP Issuer would select DROs and construct them into a DRP and list it on MCEX, completing the conversion process from a DRO to a DRP. The DRO holders are the issuers of DRPs and act as the "sellers". Qualified investors who subscribe to DRP shares through MCEX are the "buyers" ("**DRP Investor**"). A DRP Investor is entitled to the daily cash flow distributions from the underlying DROs held by the DRP stipulated by the DRP product's arrangement.

This paper aims to explain how DRC, DRO and DRP are accounted for under IFRS and CAS. It explores the accounting treatment of DRC, DRO and DRP from the perspectives of both investors and investees, highlighting their unique financial components and the impact on financial reporting.

Looking forward, Micro Connect's goal is to shape the IFRS and CAS financial reporting standards for DRC, DRO and DRP, thereby enabling financial statement readers to understand their accounting treatments and disclosures more easily.

Store Issuer's perspective

Store Issuers enter into DRCs directly with the wholly-owned subsidiaries of MCEX. Typically, a DRC has the following features:

- Throughout the contract period, the investor is entitled to receive daily revenue shares on a daily basis. An investor's daily revenue share is calculated based on predetermined sharing ratios specified in the DRC and the actual daily revenue recognised by the Store Issuer's business operations.
- The investor is entitled to receive non-shared revenue based on compensation or any other amount received in connection with a breach of the DRC by the Store Issuer or the closure of the Store Issuer.
- The combination of shared and non-shared revenue constitutes the sole means for the investor to recoup the investment amount. There is no obligation for the Store Issuer to repay the investment amount to the investor.
- There is no guarantee that the Store Issuer's business operations will continue generating any income.

From the perspective of the Store Issuer, DRC represents a financial liability as defined in IAS 32.11 and CAS 22.1.4, *"a financial liability is any liability that is (a) a contractual obligation (i) to deliver cash or another financial asset to another entity..."*. Various accounting treatments have been observed in the market, mainly comprised of financial liability at amortised cost and financial liability at fair value through profit or loss.

In the view of financial liability at amortised cost, the value of a DRC is driven by the changes in the daily revenue expected to be generated by the Store Issuer and any other non-shared revenue in connection with a breach of a DRC by Store Issuer or closure of the Store Issuer. It indicates that the revenue is a "non-financial variable" and is specific to a party to the contract. Thus, DRC fails to meet the definition of a derivative financial instrument nor contain any other embedded derivative under *IFRS 9.4.2.1(a), CAS 22.3.16 and CAS 22.4.21*. The amount of funding received by the Store Issuer is classified as financial liability at amortised cost. Accordingly, this instrument is subsequently measured at amortised cost.

In the view of Micro Connect, the financial liability at amortised cost is less relevant to reflect the attributes and features of DRC because the difference between carrying value and amortised cost is recognized in finance cost for each reporting period during contract period when DRC is classified as financial liability at amortised cost and it could be easily confused with borrowings with fixed repayment terms. **Financial liability at FVTPL is the recommended accounting treatment from Store Issuer's perspective as it is important to note that the shared and non-shared revenue components within DRC constitute a financial variable, indicating that the value of DRC fluctuates in response to specific daily revenue generated by the the Store Issuer, as well as compensation provided by Store Issuer in connection with a breach of a DRC by a Store Issuer or the closure of the Store Issuer. This variability aligns with the fundamental characteristics of a derivative financial instrument.**

Considering the characteristics of DRC, it can be categorized as a *derivative financial instrument*, in line with the criteria outlined in *IFRS 9.4.2.1(a), CAS 22.3.16 and CAS 22.4.21*. Consequently, it should be subsequently measured at fair value.

This classification and subsequent measurement align with the Store Issuer's perspective and acknowledge DRC's nature as a financial derivative due to its reliance on future shared revenue components and its inherent contingent payment structure.

The following diagram illustrates the accounting treatment of DRC in the view of Store Issuer

From the perspective of Store Issuer, DRC represents a financing arrangement, whose accounting treatment observed in the market mainly comprise of financial liability at amortised cost and financial liability at fair value through profit or loss.

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Shall the shared revenue components within DRC constitute a financial variable, indicating that the value of DRC fluctuates in response to a financial variable??

[IFRS 9.4.2.1(a); CAS 22.3.16; CAS 22.4.21]

→ Yes

DRC can be considered as having a derivative component.

[IFRS 9.4.2.1(a); CAS 22.3.16; CAS 22.4.21]

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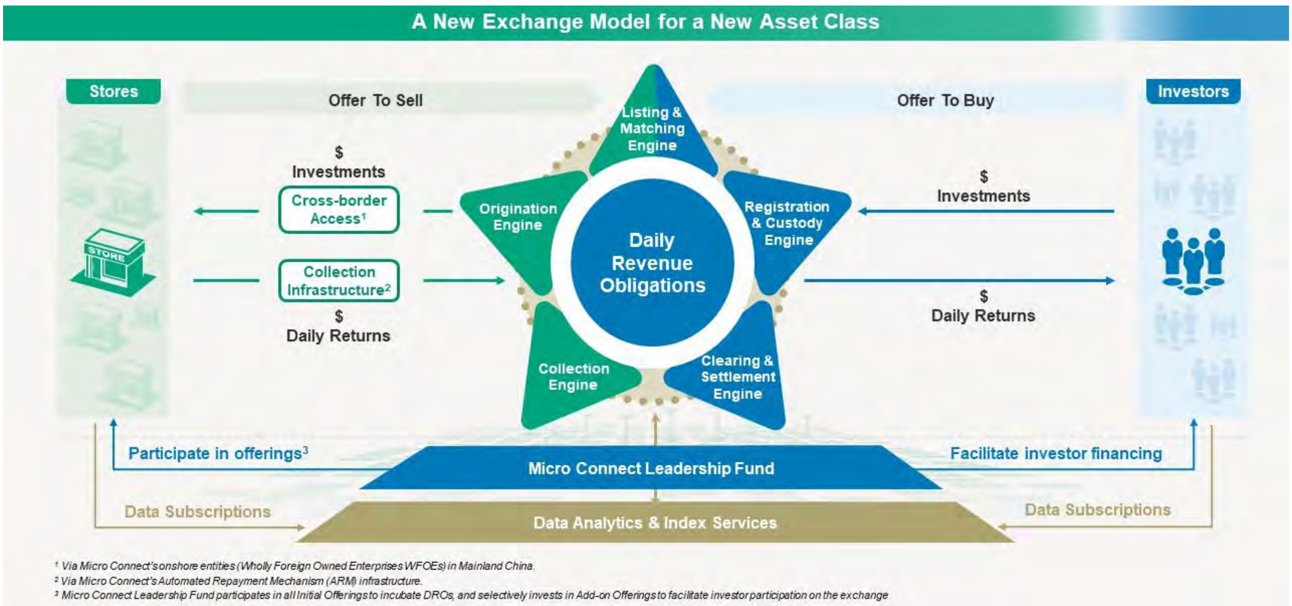
From the perspective of the Store Issuer, DRC shall be classified as financial liability at FVTPL.

[IFRS 9.4.2.1(a); CAS 22.3.16; CAS 22.4.21]



The following is an illustrative example of accounting treatment from the Store Issuer perspective under IFRS and CAS:

Assumptions:

- The total initial investment amount is RMB800,000, invested on 1 January 20X1;
- A revenue sharing ratio of 10% is applied to DRO Investor receiving daily shared revenue until the expiration of DRC. The expected life span of DRC and corresponding DRO is 3 years, covering the years ended 20X1, 20X2 and 20X3.
- DRO Investor immediately receives cash upon revenue recognition by Store Issuer.
- The shared revenue is settled in cash.
- Market risks including credit risk are assumed to remain stable throughout the contract period, thus maintaining an unchanged discount rate.
- The discount rate is 15%.
- The revenue of the Store Issuer for the years ended 31 December 20X1 and 20X2 is RMB 2,700,000 and RMB 3,100,000, respectively. ,. The net amount received by the DRO Investor for the years ended 31 December 20X1 and 20X2 is RMB 270,000 and RMB 310,000, respectively. For simplicity, no taxes or fees are charged to DRO Investor.
- The fair value of DRC as of 31 December 20X1 and 20X2 is RMB590,000 and RMB310,000 calculated based on the income approach with key inputs of projected cash flow, expected life span of DRC and discount rate.
- Assumptions during the year ended 31 December 20X3:
  - Scenario 1: The Store Issuer is under continuous operation during the contract period, revenue of Store Issuer is RMB3,400,000 and the net amount received by DRO investor is RMB340,000 for the year ended 20X3.
  - Scenario 2: The Store Issuer closed down on 30 June 20X3 and the relevant DRC was terminated accordingly. Before closure, Store Issuer generated RMB1,000,000 in revenue and RMB50,000 has been collected from disposal of assets and entitled to DRO investor. The net amount received by DRO investor during the year ended 31 December 20X3 is RMB150,000.

The table below summarizes the amounts of total investment amount/(net amount paid by Store Issuer), fair value and fair value change at initial investment date and each year end/period end.

Date	Total investment amount/ (net amount paid by Store Issuer)	Fair value	Fair value change
	RMB'000	RMB'000	RMB'000
At initial investment	800	800	0
As of 31 December 20X1	(270)	590	60
As of 31 December 20X2	(310)	310	30
As of 31 December 20X3 (Scenario 1)	(340)	0	30
As of 31 December 20X3 (Scenario 2)	(150)	0	(160)

Accounting entries in the perspective of Store Issuers are presented below:

Upon receival of initial investment	
Dr. Cash and cash equivalents	800
Cr. Financial liabilities at FVTPL	800

During the year ended 31 December 20X1	
Payments for shared revenue:	
Dr. Financial liabilities at FVTPL	270
Cr. Cash and cash equivalents	270
Recognise fair value change in fair value at year end:	
Dr. Fair value change of financial liabilities at FVTPL	60
Cr. Financial liabilities at FVTPL	60

During the year ended 31 December 20X2	
Payments for shared revenue:	
Dr. Financial liabilities at FVTPL	310
Cr. Cash and cash equivalents	310
Recognise fair value change in fair value at year end:	
Dr. Fair value change of financial liabilities at FVTPL	30
Cr. Financial liabilities at FVTPL	30

During the year ended 31 December 20X3

Scenario 1 - continuous operation	
Payments for shared revenue:	
Dr. Financial liabilities at FVTPL	340
Cr. Cash and cash equivalents	340
Recognise fair value change in fair value at year end:	
Dr. Fair value change of financial liabilities at FVTPL	30
Cr. Financial liabilities at FVTPL	30

Scenario 2 - early termination	
Payments for Shared Revenue and Non-Shared Revenue	
Dr. Financial liabilities at FVTPL	150
Cr. Cash and cash equivalents	150
Recognise fair value change in fair value at year end:	
Dr. Financial liabilities at FVTPL	160
Cr. Fair value change of financial liabilities at FVTPL	160

The following is the illustrative presentation of the statement of financial position as of the end of 20X1, 20X2 and 20X3 and the statement of profit or loss and other comprehensive income for 20X1, 20X2 and 20X3 in Store Issuer's perspective.

STATEMENT OF FINANCIAL POSITION AS AT THE END OF 20X1, 20X2 and 20X3

	20X1	20X2	20X3 (For both Scenario 1 and Scenario 2)
	Amount	Amount	Amount
	RMB'000	RMB'000	RMB'000
Assets			
Liabilities			
Financial liabilities at FVTPL - DRC (Note)	590	310	0
Capital and reserves			
Total equity			
Total equity and liabilities			

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME EXTRACT FOR THE YEAR ENDED 20X1, 20X2 and 20X3

	20X1	20X2	20X3 (Scenario 1)	20X3 (Scenario 2)
	Amount	Amount	Amount	Amount
	RMB'000	RMB'000	RMB'000	RMB'000
Fair value change of financial liabilities at FVTPL - DRC	(60)	(30)	(30)	160
Profit / (Loss) for the year				
Other comprehensive income / (expense)				
Total comprehensive income / (expense) for the year				

Note: The above list out financial liabilities and its fair value change for illustrative purpose only, other accounts have not been included.

Material accounting policy information

Financial liabilities

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL when the financial liability is (i) contingent consideration of an acquirer in a business combination to which IFRS 3 applies, (ii) held for trading or (iii) designated as at FVTPL.

A financial liability other than a financial liability held for trading or contingent consideration of an acquirer in a business combination may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- **it forms part of a contract containing one or more embedded derivatives, and IFRS 9 permits the entire combined contract to be designated as at FVTPL.**

Note for Financial liabilities at FVTPL

	At the end of 20X1	At the end of 20X2	At the end of 20X3
	RMB'000	RMB'000	RMB'000
Financial liabilities at FVTPL - DRC	590	310	0

DRC is a contractual agreement with an investor in which the investor agrees to provide funding to the Company for its business operations and the Company agrees to share a percentage of revenue generated during the contract period. DRO is an instrument that is tradable, registered, and custodied on MCEX, representing economic entitlements to its corresponding DRC.

DRC is initially recorded at fair value with reference to projected cash flow, expected life span of DRC and discount rate. Revenue sharing paid to DRO Investors reduces the carrying value of the DRC. The DRC is revalued at each reporting date at its fair value.

The following table shows the movements of financial liabilities at FVTPL.

	Financial liabilities at FVTPL
	RMB'000
At 1 January 20X1	0
Receival of investment amounts	800
Repayment of financial liabilities at FVTPL	(270)
Net fair value change	60
At 31 December 20X1	590
Repayment of financial liabilities at FVTPL	(310)
Net fair value change	30
At 31 December 20X2	310
Scenario 1 - continuous operation	
Repayment of financial liabilities at FVTPL	(340)
Net fair value change	30
At 31 December 20X3	0
Scenario 2 - early termination	
Repayment of financial liabilities at FVTPL	(150)
Net fair value change	(160)
At 31 December 20X3	0

Financial instruments

Fair value measurements of financial instruments*

Financial asset	Fair value as at			Fair value hierarchy	Valuation technique(s) and key input(s)	Significant unobservable input(s)
	RMB'000	RMB'000	RMB'000			
	20X1	20X2	20X3			
Financial liabilities at FVTPL - DRC	590	310	0	Level 3	Income approach with key inputs of projected cash flow, expected life span of DRC and discount rate	Discount rate and projected cash flow

* The above note for financial instruments is for illustrative purpose only and please refer to *IFRS 13:93(d)* for complete disclosure requirements.

DRO Investor's perspective

DRO Investors subscribe to DROs on MCEX with DRCs as the underlying asset. Typically, a DRO has the following features:

- A DRO corresponds with a particular DRC and takes effect simultaneously with the corresponding DRC The rights and obligations arising from DRCs are transferred from the wholly - owned subsidiaries of MCEX to the DRO investors by way of novation through a series of contractual agreements. The arrangement is approved by AMCM.
- DRO Investors have no authority to participate in the financial and operating policy decisions of Store Issuers.
- Throughout the contract period, DRO investors are entitled to receive daily revenue shares, net of relevant fees and taxes, charged on a daily basis. This revenue is calculated based on predetermined sharing ratios specified in DRC and the actual daily revenue recognised by the Store Issuer's business operations;
- The investor is entitled to receive non-shared revenue calculated based on compensation or any other amount received in connection with a breach of a DRC by the Store Issuer or the closure of the Store Issuer;
- The shared and non-shared revenue is the only way for the investor to recover the investment amount. Besides, there are no obligations for Store Issuers to repay the investment amount to DRO Investors; and
- There is no guarantee that the Store Issuer's business operations must generate any income.

DRO Investor has no power to participate in the financial and operating policy decisions of the Store Issuer, indicating that DRO Investor cannot control the investee and does not have significant influence over the investee. Thus, the DRO arrangement fails to meet *the criteria for control* under *IFRS 10.7* and *CAS 33.2.7* and *investment using equity method* under *IAS 28.16* and *CAS 2.1.2*. From the perspective of the DRO Investor, DRO represents a financial asset as defined in IAS 32.11 and CAS 22.1.3"*a financial asset is any asset that is (a) a contractual right (i) to receive cash or another financial asset from another entity…*".

DRO does not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, which distinguishes it from "traditional" interest-bearing financial instrument. Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest.

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However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. *[IFRS 9.B.4.1.7A and CAS 22.3.16]* In a "typical" loan arrangement such as a bank loan or the examples illustrated in *IFRS 9.B.4.1.13*, the cash flows comprise of interest payments and repayment of the principal amount.

The investments in DRO, however, have unique cash flow components, such as an agreed percentage of actual daily revenue ("**Shared Revenue**") and compensation or any other amount received in connection with a breach of a DRC by the Store Issuer or the closure of the Store Issuer ("**Non-Shared Revenue**"), which are contingent on the performance and specific events related to the investee. **Shared revenue** is directly linked to the success of the investee, meaning that it fluctuates based on the investee's performance. **This inherent variability in cash flows is characteristic of a *revenue-sharing arrangement* and is not consistent with the fixed and determinable nature of traditional interest payments in a basic lending arrangement.** The existence of **Non-Shared Revenue** is linked to compensation or any other amount received in connection with a breach of a DRC by the Store Issuer or the closure of the Store Issuer. These revenues are contingent upon the occurrence of specific events and the store's ability to realise proceeds from the disposal of existing assets during store closure liquidation, rather than being solely based on time value of money and credit risk.

An entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss ("FVTPL") under *IFRS 9.4.1.1* and *CAS 22.3.16*. Considering the characteristics of its cash flow components, the DRO fails to meet the criteria set forth for "*solely payments of principal and interest*" *("SPPI")* under *IFRS 9.4.1.2(b)* and *CAS 22.3.17*. Consequently, DRO Investor shall classify the investments in DRO as financial assets measured at FVTPL. This classification aligns with the recognition of DRO's unique cash flow structure and the inherent uncertainties linked to **Shared Revenue** and **Non-Shared Revenue** components. After the initial recognition, the carrying value of DRO is reduced when the **Shared Revenue** and **Non-Shared Revenue** are received from an investee. The fair value of DRO is revalued at each reporting date and changes in fair value are recognised in profit or loss.

The following diagram illustrates the accounting treatment of DRO in the perspective of the DRO investor

Does the DRO Investor have power to participate in the financial and operating policy decisions of the Store Issuer, which indicates that DRO Investor is able to control the investee and has significant influence over the investee?

[IFRS 10.7; IAS 28.16; CAS 33.2.7; CAS 2.1.2]

↓ NO

DRO arrangement fails to meet the criteria for control under *IFRS 10.7, CAS 33.2.7* and investment using equity method under *IAS 28.16 and CAS 2.1.2.*

↓

Are DRO's contractual cash flows consistent with basic lending arrangement?

[IFRS 9.B.4.1.7A; IFRS 9.B.4.1.13; IFRS 9.4.1.2(b); CAS 22.3.16]

↓ NO

Does DRO meet the criteria set forth for "*solely payments of principal and interest*" *("SPPI") under IFRS 9.4.1.2(b) and CAS 22.3.17*

↓ NO

DRO's cash flows are contingent on the performance and specific events related to the investee. DRO Investor shall classify the investments in DRO as financial assets at FVTPL

[IFRS 9.4.1.2(b); CAS 22.3.19]

The following is an illustrative example of accounting treatment in the perspective of DRO Investor under IFRS and CAS.

(The assumptions remain the same as the illustrative example stated in "Store Issuer's perspective" section)

Accounting entries for the perspective of DRO Investor are presented below.

Upon payment of initial investment:	
Dr. Financial assets at FVTPL	800
Cr. Cash and cash equivalents	800

During the year ended 31 December 20X1:	
Receive shared revenue:	
Dr. Cash and cash equivalents	270
Cr. Financial assets at FVTPL	270
Recognise fair value change in fair value at year end:	
Dr. Financial assets at FVTPL	60
Cr. Fair value change of financial assets at FVTPL	60

During the year ended 31 December 20X2:	
Receive shared revenue:	
Dr. Cash and cash equivalents	310
Cr. Financial assets at FVTPL	310
Recognise fair value change in fair value at year end:	
Dr. Financial assets at FVTPL	30
Cr. Fair value change of financial assets at FVTPL	30

During the year ended 31 December 20X3:

Scenario 1 - continuous operation	
Receive shared revenue:	
Dr. Cash and cash equivalents	340
Cr. Financial assets at FVTPL	340
Recognise fair value change in fair value at year end:	
Dr. Financial assets at FVTPL	30
Cr. Fair value change of financial assets at FVTPL	30

Scenario 2 - early termination	
Receive Shared Revenue and Non-Shared Revenue:	
Dr. Cash and cash equivalents	150
Cr. Financial assets at FVTPL	150
Recognise fair value change in fair value at year end:	
Dr. Fair value change of financial assets at FVTPL	160
Cr. Financial assets at FVTPL	160

The following is the illustrative presentation of the statement of financial position as at the year end of 31 December 20X1, 20X2 and 20X3 and the statement of profit or loss and other comprehensive income for 20X1, 20X2 and 20X3 in DRO Investor's perspective.

STATEMENT OF FINANCIAL POSITION EXTRACT AS AT THE YEAR END OF DECEMBER 31 20X1, 20X2 and 20X3

	20X1	20X2	20X3 (For both Scenario 1 and Scenario 2)
	Amount	Amount	Amount
	RMB'000	RMB'000	RMB'000
Assets			
Financial assets at FVTPL - DRO (Note)	590	310	0
Liabilities			
Capital and reserves			
Total equity			
Total equity and liabilities			

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME EXTRACT FOR THE YEAR ENDED 31 DECEMBER 20X1, 20X2 and 20X3

	20X1	20X2	20X3 (Scenario 1)	20X3 (Scenario 2)
	Amount	Amount	Amount	Amount
	RMB'000	RMB'000	RMB'000	RMB'000
Fair value changes of financial assets at FVTPL - DRO	60	30	30	(160)
Profit / (Loss) for the year				
Other comprehensive income / (expense)				
Total comprehensive income / (expense) for the year				

Note: The above list out financial assets and its fair value change for illustrative purpose only, other accounts have not been included.

Material accounting policy information for financial assets at FVTPL

Financial assets

Classification and subsequent measurement of financial assets

Financial assets that meet the following conditions are subsequently measured at amortised cost:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt instruments that meet the following conditions are subsequently measured at fair value through other comprehensive income ("FVTOCI"):

- the financial asset is held within a business model whose objective is achieved by both selling and collecting contractual cash flows; and
- the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other financial assets are subsequently measured at FVTPL.

Financial assets at FVTPL

Financial assets that do not meet the criteria for being measured at amortised cost or FVTOCI are measured at FVTPL.

Financial assets at FVTPL are measured at fair value at the end of the reporting period, with any fair value gains or losses recognised in profit or loss. The net gain or loss recognised in profit or loss includes any dividend or interest earned on the financial asset and is included in the "other gains and losses" line item.

Explanation Note for Financial Assets at FVTPL

	20X1	20X2	20X3
	RMB'000	RMB'000	RMB'000
Investments in DRO	590	310	0

DRC is a contractual agreement with Store Issuer in which DRO Investor agrees to provide fundings to the Store Issuer for their business operations and the Store Issuer agrees to share a percentage of revenue generated during the contract period. DRO is an instrument that is tradable, registered, and custodied on MCEX, and represents economic entitlements to its corresponding DRC.

Investments in DRO are initially stated at fair value with reference to projected cash flow, expected life span of DRO and discount rate. Revenue sharing received from the Store Issuer reduces the carrying value of the DRO. The DRO is revalued at each reporting date at its fair value.

The following table shows the movement of financial assets at FVTPL.

	Investments in DRO
	RMB'000
As of 1 January 20X1	0
Acquisitions	800
Net amount received from financial assets at FVTPL	(270)
Net fair value change	60
As of 31 December 20X1	590
Net amount received from financial assets at FVTPL	(310)
Net fair value change	30
As of 31 December 20X2	310
Scenario 1 - continuous operation	
Net amount received from financial assets at FVTPL	(340)
Net fair value change	30
As of 31 December 20X3	0
Scenario 2 - early termination	
Net amount received from financial assets at FVTPL	(150)
Net fair value change	(160)
As of 31 December 20X3	0

Explanation Note for Financial Instruments

Fair value measurements of financial instruments*

Financial asset	Fair value as at			Fair value hierarchy	Valuation technique(s) and key input(s)	Significant unobservable input(s)
	RMB'000	RMB'000	RMB'000			
	20X1	20X2	20X3			
Financial assets at FVTPL - Investments in DRO	590	310	0	Level 3	Income approach with key inputs of projected cash flow, expected life span of DRO and discount rate	Discount rate and projected cash flow

*The above note for financial instruments is for illustrative purpose only and please refer to IFRS 13:93(d) for complete disclosure requirements.

DRP Issuer's perspective

DRP is a collection of DROs assembled according to specific investment guidelines and criteria. Typically, DRP has the following features:

- DRP issuer would select DROs and construct them into a DRP and list it on MCEX, completing the conversion process from a DRO to a DRP.
- A DRP investor is entitled to the daily cash flow distributions from the underlying DROs held by the DRP stipulated by the DRP product's arrangement.
- DRP enables the creation of a wide range of products with specific themes or structures based on the nature of the store's business or the cash flow characteristics of the underlying DROs; and
- DRP can be structured in tranches, such as the "senior–mezzanine–junior", to meet the needs of investors with different risk appetites.

As the subordinated interest (junior) held by DRP Issuer absorbs the losses for underlying DROs, the DRP arrangement may provide credit enhancement. The pass-through tests as described in *IFRS 9.3.2.5* and *CAS 23.3.6* must be considered prior to considering the DRP Issuer's exposure to risks and rewards. If the pass-through tests are applied and met, DRP Issuer must consider the extent to which the risks and rewards of the asset are transferred under *IFRS 9.3.2.6* and *CAS 23.3.7*. **It should be noted that there is no example in IFRS 9 of the methodology to be used in performing the risks and rewards assessment and may involve complex quantitative analyses / modelling exercises depending on the structure. The methodology used should be consistently applied to all transfers that are similar in nature.**

Scenario 1: Transferred Substantially All the Risks and Rewards of Ownership

In this DRP arrangement, where **substantially all the risks and rewards of ownership of the underlying DROs are transferred from DRP Issuers to DRP Investors, from the DRP Issuer's perspective, the underlying DROs shall be derecognised** in accordance with *IFRS 9.3.2.6* and *CAS 23.3.7*.

The following is an illustrative example of accounting treatment in the perspective of DRP Issuer under IFRS and CAS for Scenario 1. Assume a DRP Issuer selects 2,000 DROs and construct them into a DRP. The DRP Investors paid RMB 20,000,000 to subscribe for the DRP and the DRP Investor shall have full entitlement to all the cash flows of the underlying DROs during the whole lifespan of the underlying DROs. The contractual terms of the subscription agreement indicate that (1) the DRO rights and obligations of underlying DROs are transferred from the DRP Issuer to the DRP Investors and (2) the arrangement meets the conditions under *IFRS 9.3.2.5 and CAS 23.3.6*, i.e. pass-through test is met. In addition, the DRP Issuer does not have any ongoing exposure to the DRP (e.g.,no subordinated interest of the DROs is retained by the DRP Issuer and no put option is held by the DRP Investors such that the DRP Issuer has no obligation to repurchase the relevant DROs).

Under this scenario, it may be appropriate to consider that the DRP Issuer has transferred substantially all the risks and rewards of ownership of the underlying 2,000 DROs to the DRP Investors, from the perspective of DRP Issuer, the underlying DROs shall be derecognised and the RMB 20,000,000 received from DRP Investors shall be treated as proceeds received from disposal of the underlying DROs.

Scenario 2: Retained Substantially All the Risks and Rewards of Ownership

Contrastingly, in the DRP arrangement where **substantially all the risks and rewards of ownership are retained, from DRP Issuer's perspective, they continue to recognise the investments in the underlying DROs financial assets** in accordance with *IFRS 9.3.2.6 and CAS 23.3.7*, and the accounting treatment aligns with DRO Investor's treatment for investments in DRO as specified in the "DRO Investor's perspective" section. The funding received from DRP Investor is classified as financial liabilities, and both the initial and subsequent measurements of these financial liabilities align with Store Issuer's treatment as specified in the "Store Issuer's perspective" section. However, the primary difference arises from distinct contractual arrangements. Specifically, DRP Issuer enters a DRP arrangement with DRP Investor and Store Issuer enters a DRC arrangement with the subsidiaries of MCEX on behalf of DRO Investor.

The following is an illustrative example of accounting treatment in the perspective of DRP Issuer under IFRS and CAS for Scenario 2. Assume a DRP Issuer selects 2,000 DROs and construct them into a DRP, which is structured in senior-junior tranches. DRP cash flows adhere to a senior-junior class arrangement with senior class ("Product") contribution at 80% and junior class contribution at 20%. DRP Investors of the Product (i.e., senior class) shall have full entitlement to the cash flows of the underlying DROs until the DRP investors receive the amount equivalent to the interest and the investment principal corresponding to the annualized interest for the senior class tranche. The contractual terms of the subscription agreement indicate that (1) the DRO rights and obligations of underlying DROs are transferred from the DRP Issuer to the DRP Investors and (2) the arrangement meets the conditions under *IFRS 9.3.2.5* and *CAS 23.3.6*, i.e. pass-through test is met. The DRO Issuer retained the entire junior tranche of the DRP. The annualized interest rate for the senior class tranche is 8% and the DRP Investors paid RMB 15,000,000 to subscribe for the senior tranche of the DRP. Information on expected return and collection and historical experience show that it is highly unlikely that the DRP Investor will suffer any losses. The expected losses and variability will likely be absorbed by the junior tranche held by the DRP Issuer.

Under this scenario, it may be appropriate to consider that the DRP Issuer retains substantially all the risks and rewards of ownership of the underlying 2,000 DROs, from perspective of the DRP Issuer which result in the underlying DROs continuing to be recognised as financial assets at FVTPL in its entirety for the underlying DRO arrangements do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding and fails to meet the criteria set forth for SPPI under *IFRS 9.4.1.2(b) and CAS 22.3.17*. The RMB 15,000,000 received from DRP Investors shall be classified as financial liabilities at FVTPL as the DRP cashflow is entitled from **Shared Revenue** and **Non-Shared Revenue** components from the underlying DROs which constitute a financial variable and this variability aligns with the fundamental characteristics of a derivative financial instrument.

Scenario 3: Neither Transferred Nor Retained Substantially All the Risks and Rewards of Ownership

Under *IFRS 9.3.2.6* and *CAS 23.3.7*, in the DRP arrangement where **neither substantially all the risk and rewards of ownership has been transferred nor been retained, DRP Issuer shall determine whether it has retained control of the financial asset.** Whether DRP Issuer has retained control of the underlying DROs depends on DRP Investor's ability to sell the underlying DROs. If DRP Investor has the practical ability to sell the underlying DROs 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, DRP Issuer has not retained control, otherwise it has retained control under *IFRS 9.3.2.9* and *CAS 23.3.9*.

i. **if DRP Issuer has not retained control, it shall derecognise the investment in underlying DROs** and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

ii. **if DRP Issuer has retained control, it shall continue to recognise the investment in underlying DROs to the extent of its continuing involvement in the investment in underlying DROs.** The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset.

The following is an illustrative example of accounting treatment in the perspective of DRP Issuer under IFRS and CAS for Scenario 3. The assumptions remain the same as the illustrative example stated in Scenario 2 except that information on expected return and collection and historical experience show that it is likely that both the DRP Investors and DRP Issuer will suffer some extent of losses from DRP. Calculations show that the DRP Issuer will retain more than insignificant variability of losses after the transfer.

Under this scenario, it may be considered that the DRP Issuer has neither transferred nor retained substantially all the risks and rewards of ownership of the underlying DROs from the perspective of the DRP Issuer. Consequently, the DRP Issuer shall determine whether it has retained control over the underlying DROs, ie. the practical ability to sell the underlying DROs in its entirety to an unrelated third party and the ability unilaterally and without needing to impose additional restrictions on the transfer. If the DRP Issuer has not retained control of the underlying DROs, the underlying DROs shall be derecognized (and the DRP Issuer shall recognise separately as assets or liabilities any rights and obligations created or retained in the transfer). On the other hand, if the DRP Issuer has retained control of the underlying DROs, the underlying DROs shall be recognised to the extent of continuing involvement in the investment in underlying DROs.

Diagram on the accounting treatments of DRP in the view of DRP Issuer

Whether the pass-through tests as described in IFRS 9.3.2.5 and CAS 23.3.6 are applied?

[IFRS 9.3.2.5; CAS 23.3.6]

Yes

DRP Issuer must consider the extent to which the risks and rewards of ownership of the asset are transferred under *IFRS 9.3.2.6 and CAS 23.3.7*

[IFRS 9.3.2.6; CAS 23.3.7]

Transferred Substantially All the Risks and Rewards of Ownership

[IFRS 9.3.2.6; CAS 23.3.7]

The underlying DROs shall be derecognised

[IFRS 9.3.2.6; CAS 23.3.7]

Retained Substantially All the Risks and Rewards and Ownership

[IFRS 9.3.2.6; CAS 23.3.7]

Continue to recognise the transferred asset. The accounting treatment aligns with the DRO Investor's treatment for DRO arrangement as financial assets at FVTPL

[IFRS 9.3.2.6; CAS 23.3.7]

Neither Transferred Nor Retained Substantially All the Risks and Rewards of Ownership

[IFRS 9.3.2.6; CAS 23.3.7]

The DRP Issuer shall determine whether it has retained control of the financial asset

[IFRS 9.3.2.6; CAS 23.3.7]

Whether the DRP Investor has the practical ability to sell the underlying DROs 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?

[IFRS 9.3.2.9; CAS 23.3.9]

Yes

DRP Issuer has not retained control

[IFRS 9.3.2.9; CAS 23.3.9]

DRP Issuer shall derecognise the investment in underlying DROs, and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer

[IFRS 9.3.2.9; CAS 23.3.9]

No

DRP Issuer has retained control

[IFRS 9.3.2.9; CAS 23.3.9]

DRP Issuer shall continue to recognise the investment in underlying DROs to the extent of its continuing involvement in the investment in underlying DROs

[IFRS 9.3.2.9; CAS 23.3.9]

DRP Investor's Perspective

From the perspective of DRP investor, as the cash flows are derived from daily distribution of underlying DROs which fluctuates based on the performance of micro or small business enterprises or operations, it fails to meet the criteria set forth *for "solely payments of principal and interest" ("SPPI")* , the **accounting treatment from DRP Investor's perspective aligns with DRO Investor's perspective of accounting treatment for DRO arrangement under *IFRS 9.4.1.2(b) and CAS 22.3.16*, as specified in the"DRO Investor's perspective"section**

The following diagram illustrates the accounting treatment of DRP in the view of DRP Investor

From the perspective of DRP investor, as the cash flows are derived from daily distribution of underlying DROs.

→

Are DRP's cash flows consistent with basic lending arrangement?

[IFRS 9.B.4.1.7A; IFRS 9.B.4.1.13; IFRS 9.4.1.2(b); CAS 22.3.16]

→ No

DRP's cash flows are contingent on the performance of micro or small business enterprises or operations. Thus, it doesn't meet the criteria set forth for "solely payments of principal and interest" ("SPPI") under *IFRS 9.4.1.2(b) and CAS 22.3.16.*

→

DRP Investor shall classify the investments in DRP as financial assets at FVTPL

[IFRS 9.4.1.2(b); CAS 22.3.16]

Conclusion

The following table summarises a comprehensive overview of Micro Connect's position on accounting treatments from the various perspectives discussed above.

Perspective			Financial instruments	Accounting treatment position: Statement of financial position	Accounting treatment position: Statement of profit or loss and other comprehensive income
Store Issuer			DRC	Financial liabilities at FVTPL	Fair value change of financial liabilities at FVTPL
DRO Investor			DRO	Financial assets at FVTPL	Fair value change of financial assets at FVTPL
DRP Issuer	**Scenario 1 (transfer substantially all the risks and rewards of the ownership)**		Underlying DRO	Derecognise financial assets at FVTPL - the underlying DRO	Fair value change of financial assets at FVTPL
DRP Issuer	**Scenario 2 (retain substantially all the risks and rewards of the ownership)**		DRP	Financial liabilities at FVTPL	Fair value change of financial liabilities at FVTPL
DRP Issuer	**Scenario 2 (retain substantially all the risks and rewards of the ownership)**		Underlying DRO	Financial assets at FVTPL	Fair value change of financial assets at FVTPL
DRP Issuer	**Scenario 3 (neither retain nor transfer substantially all the risks and rewards of ownership)**	Retain control	DRP	Financial liabilities at FVTPL (to the extent of its continuing involvement)	Fair value change of financial liabilities at FVTPL
DRP Issuer	**Scenario 3 (neither retain nor transfer substantially all the risks and rewards of ownership)**	Retain control	Underlying DRO	Financial assets at FVTPL (to the extent of its continuing involvement in the investment in underlying DROs, associated liability should also be recognised in relation to relevant continuing involvement)	Fair value change of financial assets at FVTPL
DRP Issuer	**Scenario 3 (neither retain nor transfer substantially all the risks and rewards of ownership)**	Not retain control	DRP	Recognise assets or liabilities any rights and obligations created or retained in the transfer	Fair value change of financial assets at FVTPL or financial liabilities at FVTPL
DRP Issuer	**Scenario 3 (neither retain nor transfer substantially all the risks and rewards of ownership)**	Not retain control	Underlying DRO	Derecognise the underlying DRO	Fair value change of financial assets at FVTPL
DRP Investor			DRP	Financial assets at FVTPL	Fair value change of financial assets at FVTPL

To our valued readers

Please note that this paper exclusively addresses accounting treatments. For inquiries regarding tax implications and fair value measurements, we recommend consulting a qualified expert. Should you require clarification or assistance regarding the accounting treatment discussed herein, we encourage you to reach out to your accounting advisors. Micro Connect values your feedback and welcomes any suggestions for improvement. You can provide feedback via the QR code or email provided below.

Email: finance@microconnect.com

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Sunnie Sy
Partner, Audit & Assurance

Daniel Lai
Partner, Audit & Assurance

Ted Ho
Partner, Assurance – Emerging Service (FSI)

Amanda Jia
Partner, Assurance - Emerging Service

Jamie Li
Senior Manager, Audit & Assurance

Lucy Lin
Manager, Audit & Assurance

For enquiries, you can consult via the QR code provided below:

Appendix
- Definitions

DRC means a "Daily Revenue Contract" entered into between subsidiaries of MCEX and the Store Issuer;

DRO means a "Daily Revenue Obligation", comprising the DRO Rights and DRO Obligations arising out of the corresponding DRC.

DRP means a "Daily Revenue Portfolio", which is a collection of DROs assembled according to specific investment guidelines, criteria, theme and structure.

DRO Obligations means, in respect of a DRC, such obligations of subsidiaries of MCEX under the DRC which are to be held by the DRO Investors holding the corresponding DRO Units pursuant to the terms of the relevant DRO Investment Agreement(s) and the Exchange Rules, provided that the obligation of the subsidiaries of MCEX under the DRC to issue invoices to the Store Issuers in respect of payment of the Shared Revenue and any Non-Shared Revenue shall remain with the subsidiaries of MCEX under the DRC.

DRO Rights means in respect of a DRC, such rights of the subsidiaries of MCEX under the DRC which are to be held by the DRO Investors holding the corresponding DRO Units pursuant to the terms of the relevant DRO Investment Agreement(s) and the Exchange Rules, provided that the right of the subsidiaries of MCEX to receive any portion of the Shared Revenue and any Non-Shared Revenue Amounts shall only be in respect of such amounts to have been actually received by the subsidiaries of MCEX from the relevant Store Issuers.

DRO Unit(s) means units in each DRO which can be Traded by DRO Investors on the Exchange Platform (in multiples of such minimum tradeable number of DRO Unit(s) as may be specified in the Exchange Rules from time to time).

DRO Investment Agreement means a "DRO Investment Agreement" entered into between subsidiaries of MCEX and an Exchange Member setting out the terms on which such Exchange Member may Trade DRO Units on the Exchange Platform.

Trading means issuing, acquiring, disposing of, transferring or subscribing to, as applicable, Exchange Products, and Traded and Trade shall have a corresponding meaning.

Exchange Platform means the platform operated by MCEX on which DRO and DRP are Traded.

Exchange Rules means the rules and operating procedures issued by MCEX in relation to the Trading of Exchange Products via the Exchange Platform, and any other rules issued from time to time by MCEX in connection with the Exchange Platform, in each case which are made available on the Exchange Platform.

Shared Revenue has the meaning given to the equivalent term or concept in the relevant DRC that corresponds with the revenue generated by the Store Issuer that is required to be paid to the relevant subsidiaries of MCEX under such DRC.

Non-Shared Revenue means any amount, other than Shared Revenue, which the subsidiaries of MCEX actually receives from a Store Issuer under a DRC, including compensation or any other amount received in connection with a breach of a DRC by the Store Issuer of a DRC or the closure of the Store Issuer.

Mainland China means the mainland of the People's Republic of China which does not include Hong Kong, Macau and Taiwan.

Hong Kong means the Hong Kong Special Administrative Region of the People's Republic of China.

Macau means the Macao Special Administrative Region of the People's Republic of China.

Investment Amount means, in respect of a DRO, the aggregate investment amount payable by the contracting subsidiaries of MCEX to the relevant Store Issuer under the corresponding DRC.

Fee means such fees and charges as prescribed by the Member Services Agreement or Exchange Rules from time to time.

Member Services Agreement means an agreement by that name entered into between MCEX and the investors, governing, among other matters (i) the provision of services by MCEX to the investors in relation to the Exchange Platform, and (ii) the investors' use of the Exchange Platform.

Tax or ***Taxation*** includes (a) taxes on gross or net income, profits and gains, and (b) all other taxes, levies, duties, imposts, charges and withholdings or any nature, including any excise, property, value added, sales, use, stamp, occupation, transfer, franchise or payroll taxes (including national insurance or social security contributions), and any payment whatsoever which the relevant person may be or become bound to make to any person as a result of the discharge by that person of any tax which the relevant person has failed to discharge, together with all penalties, charges, fees and interest relating to any of the foregoing or to any late or incorrect return in respect of any of them, and regardless of whether such taxes, levies, duties, imposts, charges, withholdings, penalties and interest are chargeable directly or primarily against or attributable directly or primarily to the relevant person or any other person and whether any amount in respect of them is recoverable from any other person.

Appendix

- Relevant IFRS Standards paragraphs

IFRS 9

3.2.5

When an entity retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met.

a. *The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.*
b. *The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.*
c. *The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in IAS 7 Statement of Cash Flows) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.*

3.2.6

An entity shall derecognise a financial asset when, and only when:

When an entity transfers a financial asset (see paragraph 3.2.4), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

a. ***if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset*** *and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.*
b. *if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.*
c. ***if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset.*** *In this case:*
   i. *if the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.*
   ii. *if the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 3.2.16).*

3.2.9

Whether the entity has retained control (see paragraph 3.2.6(c))) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee 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, the entity has not retained control. In all other cases, the entity has retained control.

3.2.17

When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:

a. *the amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost, or*
b. *equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.*

4.1.1

An entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

a. *the entity's business model for managing the financial assets and*
b. *the contractual cash flow characteristics of the financial asset.*

4.1.2

*A **financial asset** shall be measured at amortised cost if both of the following conditions are met:*

a. *the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and*
b. *the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.*

4.2.1

An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

a. *financial liabilities at **fair value** through profit or loss. Such liabilities, including **derivatives** that are liabilities, shall be subsequently measured at fair value.*

b. *financial liabilities that arise when a transfer of a* ***financial asset*** *does not qualify for* ***derecognition*** *or when the continuing involvement approach applies.* ***Paragraphs 3.2.15*** *and 3.2.17 apply to the measurement of such financial liabilities.*

c. ***financial guarantee contracts****. After initial recognition, an issuer of such a contract shall (unless* ***paragraph 4.2.1(a) or (b)*** *applies) subsequently measure it at the higher of:*

   i. *the amount of the* ***loss allowance*** *determined in accordance with* ***Section 5.5*** *and*

   ii. *the amount initially recognised (see* ***paragraph 5.1.1****) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of* ***IFRS 15****.*

d. *commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 4.2.1(a) applies) subsequently measure it at the higher of:*

   i. *the amount of the loss allowance determined in accordance with Section 5.5 and*

   ii. *the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.*

e. *contingent consideration recognised by an acquirer in a business combination to which* ***IFRS 3*** *applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.*

B4.1.7A

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money (see paragraphs B4.1.9A–B4.1.9E) and credit risk are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.

B4.1.13

The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
Instrument A *Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected*	*The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.* *However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement (see paragraph B4.1.7A).*
Instrument B *Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term.*	*The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money, for the credit risk associated with the instrument and for other basic lending risks and costs, as well as a profit margin (see paragraph B4.1.7A). The fact that the LIBOR interest rate is reset during the life of the instrument does not in itself disqualify the instrument.* *However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate. Consequently, the time value of money element is modified. Similarly, if an instrument has a contractual interest rate that is based on a term that can exceed the instrument's remaining life (for example, if an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five-year maturity), the time value of money element is modified. That is because the interest payable in each period is disconnected from the interest period.* *In such cases, the entity must qualitatively or quantitatively assess the contractual cash flows against those on an instrument that is identical in all respects except the tenor of the interest rate matches the interest period to determine if the cash flows are solely payments of principal and interest on the principal amount outstanding. (But see paragraph B4.1.9E for guidance on regulated interest rates.)* *For example, in assessing a bond with a five-year term that pays a variable rate that is reset every six months but always reflects a five-year maturity, an entity considers the contractual cash flows on an instrument that resets every six months to a six-month interest rate but is otherwise identical.* *The same analysis would apply if the borrower is able to choose between the lender's various published interest rates (eg the borrower can choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate).*

Instrument	Analysis
Instrument C *Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.*	*The contractual cash flows of both:* *(a)an instrument that has a fixed interest rate and* *(b)an instrument that has a variable interest rate* *are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money, for the credit risk associated with the instrument during the term of the instrument and for other basic lending risks and costs, as well as a profit margin. (See paragraph B4.1.7A)* *Consequently, an instrument that is a combination of (a) and (b) (eg a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a contractual term may reduce cash flow variability by setting a limit on a variable interest rate (eg an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.*
Instrument D *Instrument D is a full recourse loan and is secured by collateral.*	*The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.*
Instrument E *Instrument E is issued by a regulated bank and has a stated maturity date. The instrument pays a fixed interest rate and all contractual cash flows are non-discretionary.* *However, the issuer is subject to legislation that permits or requires a national resolving authority to impose losses on holders of particular instruments, including Instrument E, in particular circumstances. For example, the national resolving authority has the power to write down the par amount of Instrument E or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is having severe financial difficulties, needs additional regulatory capital or is 'failing'*	*The holder would analyse the contractual terms of the financial instrument to determine whether they give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and thus are consistent with a basic lending arrangement.* *That analysis would not consider the payments that arise only as a result of the national resolving authority's power to impose losses on the holders of Instrument E. That is because that power, and the resulting payments, are not contractual terms of the financial instrument.* *In contrast, the contractual cash flows would not be solely payments of principal and interest on the principal amount outstanding if the contractual terms of the financial instrument permit or require the issuer or another entity to impose losses on the holder (eg by writing down the par amount or by converting the instrument into a fixed number of the issuer's ordinary shares) as long as those contractual terms are genuine, even if the probability is remote that such a loss will be imposed.*

B5.4.6

If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. The adjustment is recognised in profit or loss as income or expense.

IFRS 10

7

an investor controls an investee if and only if the investor has all of the following elements:

a. *power over the investee;*
b. *exposure, or rights, to variable returns from involvement with the investee; and*
c. *the ability to use power over the investee to affect the amount of the investor's returns.*

B15

Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

a. *rights in the form of voting rights (or potential voting rights) of an investee;*
b. *rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;*
c. *rights to appoint or remove another entity that directs the relevant activities;*
d. *rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and*
e. *other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.*

IFRS 13

93(d)

for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

IAS 28

3

The following terms are used in this Standard with the meanings specified:

An associate is an entity over which the investor has significant influence.

Consolidated financial statements are the financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

A joint arrangement is an arrangement of which two or more parties have joint control.

***Joint control** is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. [Refer: IFRS 11 paragraphs 7–13 and B5–B11]*

A joint venture is a joint arrangement whereby the parties that have jointcontrol of the arrangement have rights to the net assets of the arrangement.

A joint venturer is a party to a joint venture that has joint control of that joint venture.

***Significant influence** is the power to participate in the financial andoperating policy decisions of the investee but is not control or joint control of those policies. [Refer: paragraphs 5–9]*

16

An entity with joint control of, or ***significant influence*** *over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 17–19.*

17

An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of IFRS 10 or if all the following apply:

a. *The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.*
b. *The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).*
c. *The entity did not file, nor is it 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.*
d. *The ultimate or any intermediate parent of the entity produces financial statements available for public use that comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10. [Refer: Basis for Conclusions paragraph BC19A]*

18

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through profit or loss in accordance with IFRS 9. An example of an investment-linked insurance fund is a fund held by an entity as the underlying items for a group of insurance contracts with direct participation features. For the purposes of this election, insurance contracts include investment contracts with discretionary participation features. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture. [Refer: Basis for Conclusions paragraphs BC19B–BC19D] (See IFRS 17 Insurance Contracts for terms used in this paragraph that are defined in that Standard.)

19

When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trustand similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with IFRS 9 regardless of whether the venture capital organisation, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. [Refer: Basis for Conclusions paragraphs BC20–BC22]

IAS 32

11

A financial liability is any liability that is:

a. *a contractual obligation:*
   i. *to deliver cash or another financial asset to another entity; or*
   i. *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 is:*
   i. *a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or*
   ii. *a derivative 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, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that 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 and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.*

A financial asset is 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 is:*
   i. *a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or*
   ii. *a derivative 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 puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that 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 and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.*

Appendix

- Relevant CAS Standards paragraphs

CAS 2

<u>Chapter 1 General provisions</u>

Article 2 *Long-term equity investments referred to in this Standard are equity investments in which the investor exercises control and significant influence over the investee, as well as equity investments in its joint ventures.*

When determining whether control can be exercised over an investee, the investor should make judgments in accordance with the relevant provisions of the "Accounting Standards for Business Enterprises No.33 - Consolidated Financial Statements". If the investor is able to exercise control over the investee, the investee is its subsidiary, except when the investor is an investment entity under the "Accounting Standards for Business Enterprises No. 33 - Consolidated Financial Statements" and the subsidiary is not included in its consolidated financial statements.

Significant influence is the power to participate in the financial and operating policy decisions of the investor to the investee but is not control or joint control over those policies. *When determining whether significant influence can be exercised over an investee, the effect of potential voting rights of the investee (for example, warrants and convertible bonds) held by the investee or other parties that are currently exercisable or convertible shall be considered. If the investor is able to exercise significant influence over the investee, the investee is its associate.*

In determining whether an investee is a joint venture, judgment shall be made in accordance with the relevant provisions of "Accounting Standards for Business Enterprises No. 40 - Joint Venture Arrangements".

CAS 22

<u>Chapter 1 General</u>

Article 3 *Financial assets refer to the cash held by an enterprise, the equity instruments of other parties and the assets that meet one of the following conditions:*

a. *Contractual rights to receive cash or other financial assets from other parties.*
b. *the contractual right to exchange financial assets or financial liabilities with other parties under potentially favorable conditions.*
c. *Non-derivative contracts that must be settled or can be settled with the enterprise's own equity instruments in the future, and the enterprise will receive a variable number of its own equity instruments under such contract.*
d. *Derivative contracts that must be settled or can be settled with the enterprise's own equity instruments in the future, except for derivative contracts in which a fixed number of its own equity instruments are exchanged for a*

fixed amount of cash or other financial assets. Among them, the enterprise's own equity instruments do not include resaleable instruments that should be classified as equity instruments in accordance with Accounting Standard for Business Enterprises No. 37 - Presentation of Financial Instruments, or financial instruments in which the issuer is obliged to deliver its net assets to the other party on a pro rata basis only at the time of liquidation, nor does it include contracts that inherently require the receipt or delivery of the enterprise's own equity instruments in the future.

Article 4 *Financial liabilities refer to liabilities of an enterprise that meet one of the following conditions: (1) the contractual obligation to deliver cash or other financial assets to other parties. (2) Contractual obligations to exchange financial assets or financial liabilities with other parties under potentially unfavorable conditions. (3) A non-derivative contract that must be settled or can be settled in the future with the enterprise's own equity instruments, and the enterprise will deliver a variable number of its own equity instruments under such contract. (4) Derivative contracts that must be settled or can be settled in the future with the enterprise's own equity instruments, except for derivative contracts in which a fixed number of its own equity instruments are exchanged for a fixed amount of cash or other financial assets. If an enterprise issues allotment shares, options or warrants to all existing holders of non-derivative equity instruments of the same class in the same proportion, so that they have the right to exchange a fixed amount of any currency for a fixed amount of the enterprise's own equity instruments in proportion, such allotment rights, options or warrants shall be classified as equity instruments. Among them, the enterprise's own equity instruments do not include resaleable instruments that should be classified as equity instruments in accordance with Accounting Standard for Business Enterprises No. 37 - Presentation of Financial Instruments, or financial instruments in which the issuer is obliged to deliver its net assets to the other party on a pro rata basis only at the time of liquidation, nor does it include contracts that inherently require the receipt or delivery of the enterprise's own equity instruments in the future.*

Chapter 3 Classification of Financial Assets

Article 16 *An entity shall classify financial assets into the following three categories based on its business model for managing financial assets and the* ***contractual cash flow*** *characteristics of the financial assets:*

a. *Financial assets at amortised cost.*
b. *Financial assets at FVTOCI.*
c. *Financial assets at FVTPL.*

The business model of an entity for managing financial assets refers to how the entity manages its financial assets to generate cash flows. The business model determines whether the source of cash flows from financial assets managed by an entity is the receipt of contractual cash flows, the sale of financial assets or both. The business model of an entity for managing financial assets shall be determined on the basis of the specific business objectives for managing financial assets as determined by the key management personnel of the entity. An entity's determination of a business model for managing financial assets shall be based on objective facts and shall not be based on circumstances that are not reasonably expected to occur.

The contractual cash flow characteristics *of financial assets refer to the contractually agreed cash flow attributes of the financial instrument that reflect the economic characteristics of relevant financial assets. The contractual cash flow characteristics of financial assets that are classified by an entity as regulated by Article 17 and Article 18 of the CAS shall be consistent with the basic lending arrangement.* ***The contractual cash flows arising from relevant financial assets at a specific date are solely payments of principal and interest based on the outstanding principal amount, where the principal amount refers to the fair value of the financial asset at initial recognition and the principal amount may change in the duration of the financial asset due to early repayment; Interest includes consideration for the time value of money, credit risk associated with the amount of principal outstanding in a specific period, and other basic lending risks, costs and profits.*** *Therein, the time value of money is the part of the interest element that provides consideration solely because of the passage of time and does not include consideration provided for other risks or costs of the financial assets held, however, there may be occasional revisions to the time value of money element. In the case of revisions to the time value of money element, the entity shall assess the relevant revisions to determine whether they meet the requirements of the contractual cash flow characteristics described above. In addition, if a financial asset contains contractual terms that could result in a change in the temporal distribution or amount of its contractual cash flows (e.g., the inclusion of an early repayment characteristics), an entity shall assess the relevant terms (e.g., assess whether the fair value of the early repayment characteristics is low) to determine whether it meets the requirements of the contractual cash flow characteristics described above.*

Article 17 *Where a financial asset meets the following conditions at the same time, it shall be classified as a financial asset measured at amortized cost:*

a. *The business model of the enterprise to manage the financial assets is to collect the cash flow of the contract.*

b. *The contractual terms of the financial asset provide that the cash flows generated on a particular date are only payments of principal and interest on the basis of the outstanding principal amount ("SPPI").*

Article 18 *Where a financial asset meets the following conditions at the same time, it shall be classified as a financial asset measured at fair value and its changes are included in other comprehensive income:*

a. *The business model of the enterprise to manage the financial assets is aimed at collecting the contracted cash flow and selling the financial assets.*

b. *The contractual terms of the financial asset provide that the cash flows generated on a specific date shall be only the payment of principal and interest on the basis of the outstanding principal amount.*

Article 19 *Financial assets other than those classified as financial assets measured at amortised cost and financial assets at FVTOCI in accordance with Article 17 and Article 18 of the CAS shall be classified by an entity as financial assets at FVTPL. An entity could designate non-trading equity instrument investments as financial assets at FVTOCI upon initial recognition and recognise dividend income in accordance with Article 65 of the CAS. The designation once made shall not be revoked.* ***If the contingent consideration recognised by an entity in a business combination not involving enterprises under common control constitutes a financial asset, the financial asset shall be classified as financial assets at FVTPL and shall not be designated as financial assets at FVTOCI.***

Chapter 4 Classification of Financial Liabilities

Article 21 *An enterprise shall classify all financial liabilities as subsequently measured at amortised cost, except for:*

a. ***financial liabilities at FVTPL,*** *including held-for-trading financial liabilities* ***(including derivatives that are financial liabilities) and financial liabilities designated as at FVTPL;***

b. *financial liabilities arising from transfer of financial assets that do not qualify for derecognition or those arising from continuing involvement in the transferred financial assets, which are measured in accordance with the relevant provisions of Accounting Standards for Business Enterprises No. 23--Transfer of Financial Assets;*

c. *financial guarantee contracts (unless paragraph (i) or (ii) applies), and commitments to provide a loan at a below-market interest rate (unless paragraph (i) applies). Upon initial recognition, the issuer of such a contract/commitment shall subsequently measure it at the higher of: (i) the amount of loss allowance determined in accordance with Chapter 8 and (ii) the amount initially recognised less the cumulative amortisation recognised in accordance with the provisions of Accounting Standards for Business Enterprises No. 14--Revenue.*

Article 22 *To provide more relevant accounting information, the enterprise may designate a financial liability as at FVTPL upon initial recognition if:*

a. *such designation can eliminate or significantly reduce accounting mismatch.*

b. *a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the enterprise's key management personnel Once made, the designation cannot be revoked.*

Accounting mismatch refers to ***a measurement or recognition inconsistency that arises from measuring assets or liabilities that are economically related or recognising the gains and losses on them*** *on different bases.*

Chapter 7 Measurement of financial instruments

Article 38 Amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition:

a. *minus the principal repayments;*

b. *plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount; and*

c. *for financial assets, adjusted for any cumulative loss allowance. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant accounting periods. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or financial liability to the carrying amount of the financial asset or to the amortised cost of the financial liability. When determining the effective interest rate, the enterprise shall estimate future cash flows by considering all contractual terms of the financial asset or financial liability including early repayment, extension, call option or other similar options, etc., without considering future credit losses.*

Article 42 *When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, an enterprise shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with Article 23 of Accounting Standards for Business Enterprises No. 24--Hedge Accounting, if applicable. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.*

CAS 23

Chapter 3

Article 6 *An enterprise transfers a financial asset if, and only if, it either:*

a. *transfers the contractual rights to receive the cash flows of the financial asset to another party, or*
b. *retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the following conditions:*
   i. *The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.*
   ii. *The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.*
   iii. *The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.*

Article 7 *When an entity transfers a financial asset, it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:*

a. *if the entity* ***transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset*** *and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.*
b. *if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.*
c. *if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset (other than circumstances that paragraphs (a) and (b) apply), the entity shall determine whether it has retained control of the financial asset. In this case:*
   i. *if the entity has not retained control, it shall derecognize the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer;*

ii. *if the entity* ***has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset*** *and recognise the relevant liability accordingly. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to risks and rewards of changes in the value of the transferred asset.*

Article 8 *The transfer of risks and rewards is evaluated by comparing the entity's exposure, before and after the transfer, to the variability in the amounts and timing of the future net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer. For example, the entity has transferred a loan in its entirety and provides full compensation for all possible losses of the loan or has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return. An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset. For example, the entity has sold a financial asset unconditionally or subject only to an option to buy it back at its fair value at the time of repurchase.*

Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

Article 9 *Whether an entity has retained the control over the transferred financial assets shall be determined by whether the transferee has the actual ability to sell the transferred financial assets. The entity has not retained the control over the transferred financial assets in the case that the transferee has the actual ability to sell the transferred financial assets, i.e., the transferee can unilaterally sell the transferred financial assets to an unrelated third party with no restrictions on the sale; In other cases, the entity has retained the control over the transferred financial assets.*

CAS 33

<u>Chapter 2</u>

Article 7 *The scope of consolidation in the consolidated financial statements shall be determined on the basis of control.*

An investor controls an investee when it has power over the investee, is exposed or has rights, to variable returns from its involvement with the investee, *and has the ability to use its power over the investee to affect its returns.*

Relevant activities herein are operations that significantly impact the investee's returns. Such activities of investees shall be determined according to the specific circumstances, which generally include sale and purchase of goods or services, management of financial assets, acquisition and disposal of assets, research and development activities, and financing activities.

Article 8 *An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to defined elements of control. The relevant facts and circumstances mainly include:*

a. *the purpose of incorporation of the investee;*

b. *the relevant activities of the investee and how it makes decisions on the relevant activities;*

c. *whether the investor has existing rights that give it the current ability to direct the relevant activities of the investee;*

d. *whether the investor is exposed, or has rights, to variable returns from its involvement with the investee;*

e. *whether the investor has the ability to use its power over the investee to affect its returns; and*

f. *the relationship between the investor and other parties.*

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