

THE FUTURE OF
FINANCIAL REPORTING
IN THE UK AND REPUBLIC OF IRELAND

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APPLICATION OF FINANCIAL
REPORTING STANDARDS

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FINANCIAL REPORTING STANDARD
FOR MEDIUM-SIZED ENTITIES

Part Two:
Draft Financial Reporting
Standards



ACCOUNTING
STANDARDS
BOARD

FINANCIAL REPORTING
EXPOSURE DRAFT

This draft is issued by the Accounting Standards Board for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by email (in Word format) to

asbcommentletters@frc-asb.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched so as to be received no later than 30 April 2011. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC and/or any of its operating bodies unless the respondent explicitly requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted.

We aim to publish responses within 10 working days of receipt.

We will publish a summary of the consultation responses, either as part of, or alongside, our final decision.

**FINANCIAL REPORTING
EXPOSURE DRAFT**

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**FINANCIAL REPORTING STANDARD
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C O N T E N T S

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SECTION I

DRAFT FINANCIAL REPORTING STANDARD

APPLICATION OF FINANCIAL REPORTING REQUIREMENTS

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[DRAFT] FINANCIAL REPORTING STANDARD: APPLICATION OF FINANCIAL REPORTING REQUIREMENTS

OBJECTIVES

- 1 The objectives of this [draft] Financial Reporting Standard (FRS) are to:
 - (a) set out the financial reporting requirements for entities preparing financial statements in the UK and Republic of Ireland; and
 - (b) set out disclosure exemptions (a reduced disclosure framework) for qualifying subsidiary undertakings.

SCOPE

- 2 This [draft] FRS applies to financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.

DEFINITIONS

- 3 An entity has **public accountability** if:
 - (a) as at the reporting date, its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
 - (b) as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit taking entity for a broad group of outsiders. This is typically the case for banks, credit

unions, insurance companies, securities brokers/dealers, mutual funds or investment banks.

- 4 A **qualifying subsidiary undertaking** is an undertaking that does not have public accountability, and whose parent undertaking prepares publicly available financial statements in which that subsidiary is included.
- 5 References in the [draft] FRS to **the Act** refer to the Companies Act 2006. References to **the Small Company Regulations** and the **Regulations** refer respectively to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

REQUIREMENT TO PREPARE FINANCIAL STATEMENTS

- 6 Subject to paragraphs 7 and 8, a reporting entity that:
- (a) has public accountability, as defined in accordance with this [draft] FRS, is required to elect (applying section 395(1)(b) of the Act) to prepare its financial statements in accordance with international accounting standards, unless it is already required to do so by law;
 - (b) is eligible to apply the Financial Reporting Standard for Smaller Entities (FRSSE) may prepare its financial statements in accordance with that standard or it may apply the [draft] Financial Reporting Standard for Medium-sized Entities (FRSME) or international accounting standards; and
 - (c) does not have public accountability, as defined in accordance with this [draft] FRS, and is not eligible to apply the FRSSE, may prepare its financial statements in accordance with the [draft] FRSME or in accordance with international accounting standards by applying section 395(1)(b) of the Act.

- 7 An entity that has public accountability and is prudentially regulated, and therefore excluded from the small companies regime by section 384(1)(b) or 384(2)(c), (d) or (e) of the Act, may apply the FRSME if one of the following applies:
- (a) it is in its first financial period and meets all three of the size conditions for a small company in section 382 of the Act; or
 - (b) it is in a subsequent year of trading and:
 - (i) all three of the size conditions are met in the reporting period and the preceding period; or
 - (ii) all three of the size conditions are met in the reporting period and the entity was qualified to apply the FRSME in the preceding period; or
 - (iii) in the preceding period, all three of the size conditions were met and the entity qualified to apply the FRSME.
- 8 A qualifying subsidiary undertaking, as defined in accordance with this [draft] FRS, may take advantage of the disclosure exemptions set out in the [draft] reduced disclosure framework of this [draft] FRS.

REDUCED DISCLOSURE FRAMEWORK FOR SUBSIDIARY UNDERTAKINGS

- 9 A qualifying subsidiary undertaking, as defined in paragraph 4, may take advantage of the disclosure exemptions set out in this [draft] reduced disclosure framework, if its shareholders have been informed about, and do not object to, the use of the disclosure exemptions.
- 10 A qualifying subsidiary undertaking which is required by section 399 of the Act to prepare group accounts, and is not entitled to any of the exemptions in sections 400 to 402 of the Act, may not take advantage of the disclosure

exemptions set out in the reduced disclosure framework in its group accounts.

- 11 An entity which applies EU-adopted IFRS and takes advantage of disclosure exemptions set out in this [draft] reduced disclosure framework, prepares Companies Act individual accounts in accordance with section 396 of the Act. Certain amendments may be necessary to international accounting standards as adopted in the European Union to comply with the Act and the Regulations. Appendix I of the [draft] FRS sets out the amendments which may be necessary to comply with the Act and the Regulations.
- 12 Where a qualifying subsidiary undertaking takes advantage of the disclosure exemptions set out in this [draft] reduced disclosure framework it must state in the notes to its financial statements:
 - (a) the exemptions adopted; and
 - (b) the name of the parent undertakings in whose consolidated financial statements its financial statements are included and from where those financial statements may be obtained.
- 13 A qualifying subsidiary which prepares its financial statements in accordance with EU-adopted IFRS is not required to comply with the requirements of IAS 7 ‘Statement of Cash Flows’.
- 14 A qualifying subsidiary which prepares its financial statements in accordance with EU-adopted IFRS may take advantage of the following disclosure exemptions:
 - (a) The requirements of paragraphs 46 to 52 of IFRS 2 ‘Share-based Payment’ where the qualifying subsidiary’s employees benefit from a group share-based payment scheme, providing equivalent disclosures are included in the consolidated financial

statements of the parent undertaking in which the subsidiary is included;

- (b) The requirements of paragraphs B64(d), (e), (g), (h), (j), (k), (l), (m), (n)(ii), (o)(ii), (p) and (q), and B67(a), (b), (c) and (e) of IFRS 3 ‘Business Combinations’ for the acquisition of a group of assets that constitute a business providing equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included;
- (c) The requirements of paragraph 33(b) of IFRS 5 ‘Non-current Assets Held for Sale and Discontinued Operations’ providing equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included;
- (d) The requirements of IFRS 7 ‘Financial Instruments: Disclosures’* providing the equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included and the subsidiary undertaking’s financial liabilities are held at amortised cost or, if they are held at fair value, held as part of a trading portfolio or they are derivatives;
- (e) The requirement in paragraph 38 of IAS 1 ‘Presentation of Financial Statements’ to present comparative information in respect of:
 - (i) paragraph 73(e) of IAS 16 ‘Property, Plant and Equipment’;

* Where a qualifying subsidiary takes advantage of this disclosure exemption it must comply with the requirements of paragraph 36(4) of Schedule 1 to the Regulations, which is achieved by providing the disclosures in IFRS 7.

- (ii) paragraph 118(e) of IAS 38 'Intangible Assets'; and
 - (iii) paragraphs 76 and 79(d) of IAS 40 'Investment Property'
- (f) The requirements of paragraphs 134 to 136 of IAS 1 'Presentation of Financial Statements';
- (g) The requirements of paragraphs 30 and 31 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors';
- (h) The requirements of paragraph 30(c) (i) and (ii) and paragraphs 120 and 120A of IAS 19 'Employee Benefits' providing equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included;
- (i) The requirements of paragraph 37 of IAS 28 'Investments in Associates' providing equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included; and
- (j) The requirements of paragraphs 134(d)(i) and (ii) 134e(i) and (ii) and 134(f) and 135(c) to (e) of IAS 36 'Impairment of Assets' providing equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included.
- 15 A qualifying subsidiary which prepares its financial statements in accordance with the [draft] FRSME may take advantage of the reduced disclosure framework set out in that FRS.
- 16 In deciding whether the consolidated financial statements of the parent undertaking provide disclosures which are

equivalent to the requirements of a specific International Financial Reporting Standard (IFRS) or the [draft] FRSME, from which relief is given in paragraphs 12 to 15 of this [draft] FRS, it is necessary to consider whether the consolidated financial statements of the parent provide disclosures that meet the basic disclosure requirements of the relevant IFRS or section of the [draft] FRSME, without implying strict conformity with each and every disclosure. The assessment should be based on the particular facts, including the similarities to, and differences from the requirements of the relevant IFRS or section of the [draft] FRSME from which relief is given.

APPLICATION OF STATEMENTS OF RECOMMENDED PRACTICE

- 17 Where an entity's financial statements fall within the scope of a Statement of Recommended Practice (SORP), the entity should state the title of the SORP and whether its financial statements have been prepared in accordance with those of the SORP's provisions currently in effect*. In the event of a departure from these provisions, the entity should give a brief description of how the financial statements depart from the recommended practice set out in the SORP, which should include:
- (a) for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances, and
 - (b) details of any disclosures recommended by the SORP that have not been provided, and the reasons why they have not been provided.

* *The provisions of a SORP will cease to have effect, for example, to the extent that they conflict with a more recent financial reporting standard.*

- 18 SORPs recommend particular accounting treatments and disclosures with the aim of narrowing areas of difference and variety between comparable entities. Compliance with a SORP that has been generally accepted by an industry or sector leads to enhanced comparability between the financial statements of entities in that industry or sector. Comparability is further enhanced if users are made aware of the extent to which an entity complies with a SORP, and the reasons for any departures. The effect of a departure from a SORP need not be quantified, except in those rare cases where such quantification is necessary for the entity's financial statements to give a true and fair view.
- 19 Entities whose financial statements do not fall within the scope of a SORP may nevertheless choose to comply with the SORP's recommendations when preparing financial statements. Where this is the case, entities are encouraged to disclose that fact.

STATEMENT OF COMPLIANCE

- 20 Where an entity prepares financial statements in accordance with the [draft] FRSME, as permitted by this [draft] FRS, it shall state in the notes to the financial statements that the financial statements have been prepared in accordance with the [draft] FRSME.
- 21 Where a qualifying subsidiary prepares financial statements in accordance with the [draft] FRSME and takes advantage of the disclosure exemptions set out in this [draft] FRS it shall state in the notes to the financial statements that the financial statements have been prepared in accordance with the [draft] FRSME as amended by the reduced disclosure framework set out in the [draft] FRS: Application of Financial Reporting Requirements.
- 22 Where a qualifying subsidiary prepares its financial statements in accordance with international accounting standards as adopted in the European Union and takes advantage of disclosure exemptions set out in this [draft]

FRS it shall state in the notes to the financial statements that the financial statements have been prepared in accordance with international accounting standards as adopted in the European Union as amended by the reduced disclosure framework set out in the [draft] FRS: Application of Financial Reporting Requirements.

DATE FROM WHICH EFFECTIVE AND TRANSITIONAL ARRANGEMENTS

- 23 An entity shall apply this [draft] FRS for accounting periods beginning on or after [1 July 2013]. Early application is permitted. The reduced disclosure framework may be applied retrospectively.
- 24 Details of FRS that are withdrawn on application of this [draft] FRS are set out in Appendix 2 [to this FRED].
- 25 On the withdrawal of current FRS, or when an entity changes the basis of preparation of its financial statements within the requirements of this [draft] FRS it shall apply the transitional arrangements relevant to its circumstances as follows:
- (a) an entity transitioning to EU-adopted IFRS shall apply the transitional arrangements set out in IFRS 1 ‘First-time adoption of International Financial Reporting Standards’.
 - (b) a qualifying subsidiary transitioning to EU-adopted IFRS and taking advantage of the disclosure exemptions set out in this [draft] FRS shall apply the requirements of paragraphs 6-33 of IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ including the relevant appendices; references to IFRSs are interpreted to mean EU-adopted IFRS as applied in paragraph 11 of this [draft] FRS.

- (c) an entity transitioning to the [draft] FRSME shall apply the transitional arrangements set out in the [draft] FRSME.
 - (d) an entity transitioning to the FRSSE shall apply the transitional arrangements set out in the FRSSE.
- 26 A qualifying subsidiary applying EU-adopted IFRS which takes advantage of the disclosure exemptions set out in this [draft] FRS for the first time shall consider whether amendments are required to comply with paragraph 10 of this [draft] FRS but does not reapply the provisions of IFRS 1. Where amendments in accordance with paragraph 11 are required, the entity shall determine whether the amendments have a material effect on the first financial statements presented. Where there is:
- (a) no material effect, the qualifying subsidiary shall disclose that it has undergone transition to, and taken advantage of, the disclosure exemptions set out in this [draft] FRS and that it has omitted certain disclosures as permitted in accordance with the reduced disclosure framework, for all periods presented.
 - (b) a material effect, the qualifying subsidiary's first financial statements shall include:
 - (i) a description of the nature of each change in accounting policy;
 - (ii) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this [draft] FRS for both the date of transition to this [draft] FRS, and the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework; and

- (iii) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this [draft] FRS for the same period.
- 27 Where paragraph 26(b) applies and it is impracticable to apply the amendments retrospectively, a qualifying subsidiary shall apply the amendments to the earliest period for which it is practicable to do so. It shall also identify the data presented for prior periods that are not comparable with data for the period in which it prepares its first financial statements that conform with the reduced disclosure framework set out in this [draft] FRS.
- 28 A qualifying subsidiary transitioning to the [draft] FRSME may take advantage of the reduced disclosure framework as set out in the [draft] FRSME in its first year of application of the [draft] FRSME.

APPENDIX 1

AMENDMENTS TO INTERNATIONAL ACCOUNTING STANDARDS AS ADOPTED IN THE EUROPEAN UNION FOR COMPLIANCE WITH THE ACT AND THE REGULATIONS

This Appendix forms an integral part of the [draft] FRS

- A1 In accordance with the Act, an entity may prepare Companies Act individual accounts or International Accounting Standards (IAS) individual accounts. An entity which applies EU-adopted IFRS and takes advantage of the reduced disclosure framework prepares Companies Act individual accounts. This Appendix to the [draft] FRS sets out the amendments to EU-adopted IFRS to achieve compliance with the Act and related Regulations (deleted text is struck-through and underlined text is inserted):
- (a) Paragraph D16 of IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ is amended as follows:
- If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:
- (a) the carrying amounts that would be included in the parent’s consolidated financial statements, based on the parent’s date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or

- (b) the carrying amounts required by the rest of this IFRS, based on the subsidiary's date of transition to IFRSs. These carrying amounts could differ from those described in (a):
- (i) when the exemptions in this IFRS result in measurements that depend on the date of transition to IFRSs.
 - (ii) when the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in IAS 16 *Property, Plant and Equipment*, whereas the group may use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

This election is available provided that a qualifying subsidiary measures its assets and liabilities in compliance with the Act in accordance with the reduced disclosure framework set out in [draft] FRS: Application of Financial Reporting Requirements.

- (b) Paragraph D17 of IFRS 1 'First-time Adoption of International Financial Reporting Standards' is amended as follows:

However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or

associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Similarly, if a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts on both financial statements, except for consolidation adjustments.

This election is available provided that a qualifying subsidiary measures its assets and liabilities in compliance with the Act in accordance with the reduced disclosure framework set out in [draft] FRS: Application of Financial Reporting Requirements.

- (c) Paragraph 34 of IFRS 3 ‘Business Combinations’ is amended as follows:

Occasionally, an acquirer will make a bargain purchase, which is a business combination in which the amount in paragraph 32(b) exceeds the aggregate of the amounts specified in paragraph 32(a). If that excess remains after applying the requirements in paragraph 36, the acquirer shall recognise ~~the resulting gain in profit or loss on the acquisition date~~ any excess in profit or loss in the periods in which the non-monetary assets acquired are recovered. The gain shall be attributed to the acquirer.

- (d) Paragraph 33 of IFRS 5 ‘Non-current Assets Held for Sale and Discontinued Operations’ is amended as follows:

An entity shall disclose:

- (a) a single amount in the statement of comprehensive income comprising the total of:

- (i) the post-tax profit or loss of discontinued operations; and
 - (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- (b) an analysis of the single amount in (a) into:
- (i) the revenue, expenses and pre-tax profit or loss of discontinued operations;
 - (ii) the related income tax expense as required by paragraph 81(h) of IAS 12;
 - (iii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and
 - (iv) the related income tax expense as required by paragraph 81(h) of IAS 12.

The analysis ~~may be~~ is presented ~~in the notes or~~ in the statement of comprehensive income. ~~If it is presented~~ In the statement of comprehensive income it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations. ~~The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale of acquisition (see paragraph 11).~~

- (c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented

either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

- (d) the amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures ~~may be~~ are presented ~~either in the notes or~~ in the statement of comprehensive income.
- (e) Paragraph 60 of IAS 1 'Presentation of Financial Statements' is amended as follows:

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 66-76 ~~except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.~~

- (f) Paragraph 61 of IAS 1 'Presentation of Financial Statements' is amended as follows:

~~Whichever method of presentation is adopted,~~ An entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- (a) no more than twelve months after the reporting period, and
- (b) more than twelve months after the reporting period.

- (g) Paragraph 87 of IAS 1 ‘Presentation of Financial Statements’ is amended as follows:

~~An entity shall not present any items of income or expense as extraordinary items, in the statement of comprehensive income or the separate income statement (if presented), or in the notes.~~

Ordinary activities are any activities which are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, these activities. Ordinary activities include any effects on the reporting entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events.

87A Extraordinary items are material items possessing a high degree of abnormality which arise from events or transactions that fall outside the ordinary activities of the reporting entity and which are not expected to recur. They do not include exceptional items (those occurring outside within the entity’s ordinary activities but which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view) nor do they include prior period items merely because they relate to a prior period.

- (h) Paragraph 28 of IAS 16 ‘Property, Plant and Equipment’ is deleted.

- (i) Paragraph 104A of IAS 19 ‘Employee Benefits’ is amended as follows:

When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. ~~In the statement of comprehensive income, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.~~

- (j) Paragraph 24 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:

Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position ~~either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.~~

- (k) Paragraph 25 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is deleted.

- (l) Paragraph 26 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:

~~One method recognises~~ The grant is recognised as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

- (m) Paragraph 27 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is deleted.

- (n) Paragraph 28 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:

The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. For this reason and in order to show the gross investment in assets, such movements are ~~often~~ disclosed as separate items in the statement of cash flows ~~regardless of whether or not the grant is deducted from the related asset for presentation purposes in the statement of financial position.~~

- (o) Paragraph 29 of IAS 20 ‘Accounting for Government Grants and Disclosure of Government Assistance’ is amended as follows:

Grants related to income are ~~sometimes~~ presented as a credit in the statement of comprehensive income, ~~either~~ separately or under a general heading such as ‘Other income’; ~~alternatively, they are deducted in reporting the related expense.~~

- (p) Paragraph 13 of IAS 28 ‘Investments in Associates’ is amended as follows:

An investment in an associate shall be accounted for in consolidated accounts using the equity method except when:

- (a) the investment is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
- (b) the exception in paragraph 10 of IAS 27, allowing a parent that also has an investment in an associate not to present consolidated financial statements, applies; or

- (c) all of the following apply:
- (i) the investor 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 investor not applying the equity method.
 - (ii) the investor'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);
 - (iii) the ultimate or any intermediate parent of the investor produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.

13A In accounts other than consolidated accounts, an investment in an associate shall be accounted for in accordance with paragraphs 38-43 of IAS 27.

- (q) Paragraph 23 of IAS 28 'Investments in Associates' is amended as follows:

An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets and liabilities is accounted for as follows:

- (a) goodwill relating to an associate is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

(b) any excess of the investor's share of the net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired periods in which the non-monetary assets acquired are recovered.

(r) Paragraph 30 of IAS 31 'Interests in Joint Ventures' is amended as follows:

In consolidated accounts, a venturer shall recognise its interest in a jointly controlled entity using proportionate consolidation or the alternative method described in paragraph 38. When proportionate consolidation is used, one of the two reporting formats identified below shall be used.

30A In accounts other than consolidated accounts an interest in a jointly controlled entity shall be accounted for in accordance with paragraphs 38 - 43 of IAS 27.

(s) Paragraph 31 of IAS 31 'Interests in Joint Ventures' is deleted.

(t) Paragraph 38 of IAS 31 'Interests in Joint Ventures' is amended as follows:

In consolidated accounts as an alternative to proportionate consolidation described in paragraph 30 a venturer shall recognise its interest in a jointly controlled entity using the equity method.

(u) Paragraph 39 of IAS 31 'Interests in Joint Ventures' is deleted.

- (v) Paragraph 124 of IAS 36 ‘Impairment of Assets’ is amended as follows:

An impairment loss recognised for goodwill shall ~~not~~ be reversed in a subsequent period if and only if the reasons for the impairment loss have ceased to apply.

- (w) Paragraph 54 of IAS 37 ‘Provisions, Contingent Liabilities and Contingent Assets’ is deleted.

APPENDIX 2

APPLICATION GUIDANCE ON THE DEFINITION OF PUBLIC ACCOUNTABILITY

This Appendix forms an integral part of the [draft] FRS

- A2.1 The aim of the guidance is to assist entities in determining whether they have public accountability as defined in this [draft] FRS.
- A2.2 This [draft] FRS, except in a limited circumstance, requires an entity which has public accountability to prepare its financial statements in accordance with EU-adopted IFRS. The definition of public accountability used in this [draft] FRS is the definition used by the IASB in its IFRS for SMEs extended to include entities that ‘take deposits for a broad group of outsiders’.
- A2.3 The IASB’s background material on public accountability, as the principle for identifying those entities for which the IFRS for SMEs is intended and those for which it is not, is set out in the IFRS for SMEs Basis for Conclusions, at paragraphs BC55 to BC77. Comments are included at the following references:
- (a) BC57(a) that the IFRS for SMEs includes a definition of public markets consistent with the definition in IFRS 8 ‘Operating Segments’.
 - (b) BC57(b) that the IFRS for SMEs clarifies if entities hold assets in a fiduciary capacity for reasons incidental to their primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises and utility companies) this does not result in those entities having public accountability.

- (c) BC58 that an entity's decision to enter a public capital market makes it publicly accountable – and it must provide the outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources.
 - (d) BC59 that the primary business of banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Because such an entity acts in a public fiduciary capacity, it has public accountability.
- A2.4 In determining if an entity has public accountability because its debt or equity instruments are traded on a public market, reference is made to the scope of IFRS 8. For the avoidance of doubt, entities which have debt or equity instruments traded in the following UK or Irish markets have public accountability (this list is not intended to be exhaustive):
- (a) London Stock Exchange;
 - (b) Irish Stock Exchange;
 - (c) Alternative Investment Market;
 - (d) Irish Enterprise Exchange;
 - (e) Plus-listed; and
 - (f) Plus-quoted.
- A2.5 In relation to entities whose shares are suspended from trading, an entity continues to have public accountability until such time as its shares or securities are delisted.

- A2.6 The IFRS for SMEs states, in paragraph 1.4, that if an entity holds assets in a fiduciary capacity for a broad group of outsiders for reasons incidental to its primary business (as, for example, as may be the case for travel or real estate agents, schools, charitable organisation, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services such as utility companies) the holding of such assets does not make them publicly accountable. The IASB notes in paragraph BC57(b) that this clarification is provided because respondents to its exposure draft noted entities often hold assets incidental to a primary business. Similarly, in the UK and Republic of Ireland holding of such assets by solicitors, accountants, and chartered surveyors does not make them publicly accountable.
- A2.7 The ASB extended the definition of public accountability to include ‘deposit taking entities for a broad group of outsiders’. The extension is consistent with paragraph BC59 of the IFRS for SMEs which includes the primary business of banks and providers of credit where the deposits are taken in a public fiduciary capacity.
- A2.8 Paragraph BC59 notes an entity has a public fiduciary capacity when it holds and manages financial resources entrusted to it by a broad group of clients, customers or members who are not involved in the management of the entity. An entity holds assets in a ‘fiduciary capacity for a broad group of outsiders’ or ‘is a deposit taking entity for a broad group of outsiders’ where the outsiders are not involved in the management of the entity and rely on general purpose financial statements as they do not have the power to demand additional financial information.
- A2.9 For the avoidance of doubt the following entities have public accountability:
- (a) A quoted company as defined by section 385 of the Companies Act 2006.

- (b) A pension scheme, under which a right to benefits results from contributions made under a pension policy. In applying international accounting standards the scheme applies the ‘Statement of Recommended Practice for Financial Reports of Pensions Schemes’.
- (c) An entity that undertakes the business of effecting or carrying out contracts of insurance, including general and life assurance entities.
- (d) A credit union, being a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act, which is an authorised person.
- (e) A building society, defined in section 119(1) of the Building Societies Act 1986 as a building society incorporated (or deemed to be incorporated) under that Act.
- (f) An incorporated friendly society or a registered friendly society.
- (g) A bank which is:
 - (a) a firm with a Part IV permission* which includes accepting deposits, and:
 - (i) which is a credit institution; or
 - (ii) whose Part IV permission includes a requirement that it comply with the rules in the General Prudential sourcebook and the Prudential sourcebook for Banks,

* As defined in section 40(4) of the Act (Application for permission) a permission given by the FSA under Part IV of the Act (Permission to carry on regulated activities), or having effect as if so given.

Building Societies and Investment Firms
relating to banks;

but which is not a building society, a friendly
society or a credit union;

(b) an EEA bank which is a full credit institution.

(h) An employee benefit trust (including employee share ownership trusts), usually a discretionary trust set up by an employer for the benefit of its employees and directors.

(i) An investment trust, Investment Company*, venture capital trust, mutual fund, exchange traded fund, unit trust, open-ended investment company (OEIC), custodian bank or stockbroker.

A2.10 Relief from the requirement to apply EU-adopted IFRS is provided for certain entities. A publicly accountable entity that is prudentially regulated, such as a credit union or building society, may apply the FRSME if it satisfies all three of the size conditions of a small company or small group as defined by section 382 or section 383 of the Companies Act 2006. To be classified as prudentially regulated for this purpose, an entity must fall within the definitions of section 384(1)(b) or 384(2)(c), (d) or (e) of the Companies Act 2006.

A2.11 The financial reporting framework for the public sector is determined by the Relevant Authority[†]. This includes those companies classified to the public sector by the Office

* An investment company is a corporate vehicle formed under section 47(3) of the Companies (Amendment) Act 1983 and section 58 of the Companies (Amendment) Act 1986, and regulated by the Irish Financial Regulator.

† The relevant authorities are determined by the UK government and the devolved administrations. At present they are HM Treasury, the Welsh Assembly Government, the Scottish Government, the Northern Ireland Assembly, CIFPA/LASAAC, the Department of Health and Monitor. In the Republic of Ireland the relevant authority is the Irish government.

for National Statistics. Companies within this sector should look to their Relevant Authority for guidance on the financial reporting framework to apply.

SECTION II

DRAFT FINANCIAL REPORTING STANDARD FOR MEDIUM-SIZED ENTITIES

C O N T E N T S

FINANCIAL REPORTING STANDARD FOR MEDIUM-SIZED ENTITIES

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The *Financial Reporting Standard for Medium-sized Entities (FRSME)* is set out in Sections 1–35 and the Glossary. Terms defined in the Glossary are in **bold type** the first time they appear in each section.

SECTION 1: SCOPE

SCOPE

- 1.1 In accordance with the [draft] Financial Reporting Standard ‘Application of Financial Reporting Requirements’ this [draft] Financial Reporting Standard is applicable to:
- (a) entities which do not have public accountability, as defined in accordance with the [draft] FRS ●, and are not eligible to apply the FRSSE;
 - (b) entities which are eligible to apply the FRSSE but which opt to apply this [draft] FRS; and
 - (c) an entity which has public accountability and is prudentially regulated, and therefore excluded from the small companies regime by section 384(1)(b) or 384(2)(c), (d) or (e) of the Act, if one of the following applies:
 - a. it is in its first financial period and meets all three of the size conditions for a small company in section 382 of the Act; or
 - b. it is in a subsequent year of trading and:
 - i. all three of the size conditions are met in the reporting period and the preceding period; or
 - ii. all three of the size conditions are met in the reporting period and the entity was qualified to apply the FRSME in the preceding period; or
 - iii. in the preceding period, all three of the size conditions were met and the entity was qualified to apply the FRSME.

- 1.2 An entity has public accountability if:
- (a) as at the reporting date its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
 - (b) as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit taking entity for a broad group of outsiders. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds or investment banks.
- 1.3 The [draft] FRS ● sets out guidance on determining whether an entity has public accountability.

REDUCED DISCLOSURE FRAMEWORK FOR SUBSIDIARY UNDERTAKINGS

- 1.4 A qualifying subsidiary undertaking is an undertaking that does not have public accountability, and whose parent undertaking prepares publicly available consolidated financial statements in which the subsidiary undertaking is included.
- 1.5 A qualifying subsidiary undertaking may take advantage of the disclosure exemptions set out in this [draft] reduced disclosure framework, if its shareholders have been informed about, and do not object to, the use of the disclosure exemptions.
- 1.6 A qualifying subsidiary undertaking which is required by section 399 of the Act to prepare group accounts, and is not entitled to any of the exemptions in sections 400 to 402 of the Act, may not take advantage of the disclosure exemptions in this reduced disclosure framework in its group accounts.

- 1.7 Where a qualifying subsidiary undertaking takes advantage of disclosure exemptions set out in paragraph 1.8 it must state in the notes to its financial statements:
- (a) the exemptions adopted; and
 - (b) the name of the parent undertakings in whose consolidated financial statements its financial statements are included and from where those financial statements may be obtained.
- 1.8 A qualifying subsidiary undertaking applying this [draft] FRS may take advantage of the following disclosure exemptions, if its shareholders have been informed about, and do not object to, the use of the exemptions:
- (a) The requirements of Section 7 ‘Statement of Cash Flows’.
 - (b) The disclosures required by Section 11 ‘Basic Financial Instruments’ paragraphs 11.39 to 11.48 and Section 12 ‘Other Financial Instrument Issues’ paragraphs 12.26 to 12.29 providing the equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included and the subsidiary undertaking’s financial liabilities are basic financial instruments or held as part of a trading portfolio or they are derivatives.
 - (c) The requirements of Section 26 ‘Share-based Payment’ paragraphs 26.19, 26.21 and 26.23, where a qualifying subsidiary’s employees benefit from a share-based payment scheme, provided the equivalent disclosures are included in the consolidated financial statements of the parent undertaking in which the subsidiary is included.
 - (d) The requirements of Section 28 ‘Employee Benefits’ paragraph 28.41(a), (b), and (e) to (k) provided the equivalent disclosures are included in the consolidated

financial statements of the parent undertaking in which the subsidiary is included.

- 1.9 Where a qualifying subsidiary prepares financial statements in accordance with the [draft] FRSME and applies the reduced disclosure framework as set out above it shall state in the notes to the financial statements that the financial statements have been prepared in accordance with the [draft] FRSME as amended by the reduced disclosure framework set out in the [draft] FRS ● ‘Application of Financial Reporting Requirements’.

SECTION 2: CONCEPTS AND PERVASIVE PRINCIPLES

SCOPE OF THIS SECTION

- 2.1 This section describes the **objective of financial statements** of entities within the scope of this FRS and the qualities that make the information in the financial statements of entities within the scope of this FRS useful. It also sets out the concepts and basic principles underlying the financial statements of entities within the scope of this FRS.

OBJECTIVE OF FINANCIAL STATEMENTS OF SMALL AND MEDIUM-SIZED ENTITIES

- 2.2 The objective of financial statements of a small or medium-sized entity is to provide information about the **financial position, performance** and **cash flows** of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
- 2.3 Financial statements also show the results of the stewardship of management—the accountability of management for the resources entrusted to it.

QUALITATIVE CHARACTERISTICS OF INFORMATION IN FINANCIAL STATEMENTS

Understandability

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

information to be omitted on the grounds that it may be too difficult for some users to understand.

Relevance

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

Materiality

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

Reliability

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

Substance over form

- 2.8 Transactions and other events and conditions should be accounted for and presented in accordance with their

substance and not merely their legal form. This enhances the reliability of financial statements.

Prudence

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

Completeness

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

Comparability

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

Timeliness

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

Balance between benefit and cost

- 2.13 The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users.
- 2.14 Financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. Individual entities also enjoy benefits, including improved access to capital markets, favourable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes.

FINANCIAL POSITION

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

- (a) An **asset** is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
 - (b) A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
 - (c) **Equity** is the residual interest in the assets of the entity after deducting all its liabilities.
- 2.16 Some items that meet the definition of an asset or a liability may not be recognised as assets or liabilities in the statement of financial position because they do not satisfy the criteria for **recognition** in paragraphs 2.27–2.32. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognised.

Assets

- 2.17 The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and **cash equivalents** to the entity. Those cash flows may come from using the asset or from disposing of it.
- 2.18 Many assets, for example property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible.
- 2.19 In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a lease is an asset if the entity controls the benefits that are expected to flow from the property.

Liabilities

- 2.20 An essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a **constructive obligation**. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from an entity's actions when:
- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept particular responsibilities, and
 - (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
- 2.21 The settlement of a present obligation usually involves the payment of cash, transfer of other assets, provision of services, the replacement of that obligation with another obligation, or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

- 2.22 Equity is the residual of recognised assets minus recognised liabilities. It may be subclassified in the statement of financial position. For example, in a corporate entity, subclassifications may include funds contributed by shareholders, retained earnings and gains or losses recognised directly in equity.

PERFORMANCE

- 2.23 Performance is the relationship of the income and expenses of an entity during a **reporting period**. This FRS permits entities to present performance in a single financial

statement (a **statement of comprehensive income**) or in two financial statements (an **income statement** and a statement of comprehensive income). **Total comprehensive income** and **profit or loss** are frequently used as measures of performance or as the basis for other measures, such as return on investment or earnings per share. Income and expenses are defined as follows:

- (a) **Income** is increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.
- (b) **Expenses** are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.

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

Income

- 2.25 The definition of income encompasses both revenue and gains.
- (a) **Revenue** is income that arises in the course of the ordinary activities of an entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties and rent.
 - (b) **Gains** are other items that meet the definition of income but are not revenue. When gains are recognised in the statement of comprehensive income, they are usually displayed separately because

knowledge of them is useful for making economic decisions.

Expenses

- 2.26 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity.
- (a) **Expenses** that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, or property, plant and equipment.
- (b) **Losses** are other items that meet the definition of expenses and may arise in the course of the ordinary activities of the entity. When losses are recognised in the statement of comprehensive income, they are usually presented separately because knowledge of them is useful for making economic decisions.

RECOGNITION OF ASSETS, LIABILITIES, INCOME AND EXPENSES

- 2.27 Recognition is the process of incorporating in the financial statements an item that meets the definition of an asset, liability, income or expense and satisfies the following criteria:
- (a) it is **probable** that any future economic benefit associated with the item will flow to or from the entity, and
- (b) the item has a cost or value that can be measured reliably.

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

The probability of future economic benefit

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

Reliability of measurement

- 2.30 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the financial statements.
- 2.31 An item that fails to meet the recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events.
- 2.32 An item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

MEASUREMENT OF ASSETS, LIABILITIES, INCOME AND EXPENSES

- 2.33 Measurement is the process of determining the monetary amounts at which an entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. This FRS specifies which measurement basis an entity shall use for many types of assets, liabilities, income and expenses.
- 2.34 Two common measurement bases are historical cost and fair value:
- (a) For assets, **historical cost** is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition. For liabilities, historical cost is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred, or in some circumstances (for example, income tax) the amounts of cash or cash equivalents expected to be paid to settle the liability in the normal course of business. Amortised historical cost is the historical cost of an asset or liability plus or minus that portion of its historical cost previously recognised as expense or income.
 - (b) **Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

PERVASIVE RECOGNITION AND MEASUREMENT PRINCIPLES

- 2.35 The requirements for recognising and measuring assets, liabilities, income and expenses in this FRS are based on pervasive principles that are derived from the IASB *Framework for the Preparation and Presentation of Financial*

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

ACCRUAL BASIS

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

RECOGNITION IN FINANCIAL STATEMENTS

Assets

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

Liabilities

- 2.39 An entity shall recognise a liability in the statement of financial position when
- (a) the entity has an obligation at the end of the reporting period as a result of a past event,
 - (b) it is probable that the entity will be required to transfer resources embodying economic benefits in settlement, and
 - (c) the settlement amount can be measured reliably.
- 2.40 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 2.39. An entity shall not recognise a contingent liability as a liability, except for contingent liabilities of an acquiree in a business combination (see Section 19 *Business Combinations and Goodwill*).

Income

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

Expenses

- 2.42 The recognition of expenses results directly from the recognition and measurement of assets and liabilities. An entity shall recognise expenses in the statement of comprehensive income (or in the income statement, if presented) when a decrease in future economic benefits

related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

Total comprehensive income and profit or loss

- 2.43 Total comprehensive income is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.
- 2.44 Profit or loss is the arithmetical difference between income and expenses other than those items of income and expense that this FRS classifies as items of other comprehensive income. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.
- 2.45 This FRS does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the ‘matching concept’ for measuring profit or loss.

MEASUREMENT AT INITIAL RECOGNITION

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

SUBSEQUENT MEASUREMENT

Financial assets and financial liabilities

- 2.47 An entity measures basic **financial assets** and basic **financial liabilities**, as defined in Section 11 *Basic Financial Instruments*, at amortised cost less impairment except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are **publicly traded** or whose fair value can otherwise be measured reliably, which are measured at fair value with changes in fair value recognised in profit or loss.

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

Non-financial assets

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

- (a) An entity measures property, plant and equipment at the lower of depreciated cost and recoverable amount.
- (b) An entity measures inventories at the lower of cost and selling price less costs to complete and sell.
- (c) An entity recognises an impairment loss relating to non-financial assets that are in use or held for sale.

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

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

- (a) [not used]
- (b) **investment property** that an entity measures at fair value (see paragraph 16.7).
- (b) agricultural assets (**biological assets** and **agricultural produce** at the point of harvest) that an entity measures at fair value less estimated costs to sell (see paragraph 34.2).

Liabilities other than financial liabilities

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

OFFSETTING

- 2.52 An entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by this FRS.
- (a) Measuring assets net of valuation allowances - for example, allowances for inventory obsolescence and allowances for uncollectible receivables - is not offsetting.
 - (b) If an entity's normal operating activities do not include buying and selling non-current assets, including investments and operating assets, then the entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the **carrying amount** of the asset and related selling expenses.

SECTION 3: FINANCIAL STATEMENT PRESENTATION

SCOPE OF THIS SECTION

- 3.1 This section explains **fair presentation** of **financial statements**, what compliance with the FRSME requires, and what is a complete set of financial statements.

FAIR PRESENTATION

- 3.2 Financial statements shall present fairly the **financial position**, financial **performance** and **cash flows** of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and **recognition** criteria for assets, liabilities, income and expenses set out in Section 2 *Concepts and Pervasive Principles*.
- (a) The application of the FRSME, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows of entities within the scope of this FRS.

(b) [not used].

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

COMPLIANCE WITH THE FRSME

- 3.3 An entity whose financial statements comply with the FRSME shall make an explicit and unreserved statement of such compliance in the **notes**. Financial statements shall not

be described as complying with the FRSME unless they comply with all the requirements of this FRS.

- 3.4 In the extremely rare circumstances when management concludes that compliance with this FRS would be so misleading that it would conflict with the **objective of financial statements** of entities within the scope of this FRS set out in Section 2, the entity shall depart from that requirement in the manner set out in paragraph 3.5 unless the relevant regulatory framework prohibits such a departure.
- 3.5 When an entity departs from a requirement of this FRS in accordance with paragraph 3.4, it shall disclose the following:
- (a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows.
 - (b) that it has complied with the FRSME, except that it has departed from a particular requirement to achieve a fair presentation.
 - (c) the nature of the departure, including the treatment that the FRSME would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2, and the treatment adopted.
- 3.6 When an entity has departed from a requirement of this FRS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.5(c).
- 3.7 In the extremely rare circumstances when management concludes that compliance with a requirement in this FRS would be so misleading that it would conflict with the

objective of financial statements of entities within the scope of this FRS set out in Section 2, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing the following:

- (a) the nature of the requirement in this FRS, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in Section 2.
- (b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.

GOING CONCERN

- 3.8 When preparing financial statements, the management of an entity using this FRS shall make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the **reporting date**.
- 3.9 When management is aware, in making its assessment, of **material** uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

FREQUENCY OF REPORTING

- 3.10 An entity shall present a complete set of financial statements (including comparative information – see paragraph 3.14) at least annually. When the end of an entity’s **reporting period** changes and the annual financial statements are presented for a period longer or shorter than one year, the entity shall disclose the following:
- (a) that fact.
 - (b) the reason for using a longer or shorter period.
 - (c) the fact that comparative amounts presented in the financial statements (including the related notes) are not entirely comparable.

CONSISTENCY OF PRESENTATION

- 3.11 An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:
- (a) it is apparent, following a significant change in the nature of the entity’s operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of **accounting policies** in Section 10 *Accounting Policies, Estimates and Errors*, or
 - (b) this FRS requires a change in presentation.
- 3.12 When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is **impracticable**. When comparative amounts are reclassified, an entity shall disclose the following:
- (a) the nature of the reclassification.

- (b) the amount of each item or class of items that is reclassified.
 - (c) the reason for the reclassification.
- 3.13 If it is impracticable to reclassify comparative amounts, an entity shall disclose why reclassification was not practicable.

COMPARATIVE INFORMATION

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

MATERIALITY AND AGGREGATION

- 3.15 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.
- 3.16 Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

COMPLETE SET OF FINANCIAL STATEMENTS

- 3.17 A complete set of financial statements of an entity shall include all of the following:
- (a) a **statement of financial position** as at the **reporting date**.

- (b) either:
 - (i) a single **statement of comprehensive income** for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining **profit or loss** (which is a subtotal in the statement of comprehensive income) and items of **other comprehensive income**, or
 - (ii) a separate **income statement** and a separate statement of comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
 - (c) a **statement of changes in equity** for the reporting period.
 - (d) a **statement of cash flows** for the reporting period.
 - (e) **notes**, comprising a summary of significant accounting policies and other explanatory information.
- 3.18 If the only changes to equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period **errors**, and changes in accounting policy, the entity may present a single **statement of income and retained earnings** in place of the statement of comprehensive income and statement of changes in equity (see paragraph 6.4).
- 3.19 If an entity has no items of other comprehensive income in any of the periods for which financial statements are presented, it may present only an income statement, or it may present a statement of comprehensive income in which the ‘bottom line’ is labelled ‘profit or loss’.

- 3.20 Because paragraph 3.14 requires comparative amounts in respect of the previous period for all amounts presented in the financial statements, a complete set of financial statements means that an entity shall present, as a minimum, two of each of the required financial statements and related notes.
- 3.21 In a complete set of financial statements, an entity shall present each financial statement with equal prominence.
- 3.22 An entity may use titles for the financial statements other than those used in this FRS as long as they are not misleading.

IDENTIFICATION OF THE FINANCIAL STATEMENTS

- 3.23 An entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. In addition, an entity shall display the following information prominently, and repeat it when necessary for an understanding of the information presented:
- (a) the name of the reporting entity and any change in its name since the end of the preceding reporting period.
 - (b) whether the financial statements cover the individual entity or a **group** of entities.
 - (c) the date of the end of the reporting period and the period covered by the financial statements.
 - (d) the **presentation currency**, as defined in Section 30 *Foreign Currency Translation*.
 - (e) the level of rounding, if any, used in presenting amounts in the financial statements.

- 3.24 An entity shall disclose the following in the notes:
- (a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office).
 - (b) a description of the nature of the entity's operations and its principal activities.

**PRESENTATION OF INFORMATION NOT
REQUIRED BY THIS FRS**

- 3.25 This FRS does not address presentation of segment information, earnings per share, or interim financial reports. An entity applying this FRS and making such disclosures shall describe the basis for preparing and presenting the information.

SECTION 4: STATEMENT OF FINANCIAL POSITION

SCOPE OF THIS SECTION

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

INFORMATION TO BE PRESENTED IN THE STATEMENT OF FINANCIAL POSITION

- 4.2 As a minimum, the statement of financial position shall include line items that present the following amounts:
- (a) cash and **cash equivalents**.
 - (b) trade and other receivables.
 - (c) **financial assets** (excluding amounts shown under (a), (b), (j) and (k)).
 - (d) **inventories**.
 - (e) **property, plant and equipment**.
 - (f) **investment property** carried at fair value through profit or loss.
 - (g) **intangible assets**.
 - (h) **biological assets** carried at cost less accumulated depreciation and impairment.
 - (i) biological assets carried at fair value through profit or loss.

- (j) investments in **associates**.
 - (k) investments in **jointly controlled entities**.
 - (l) trade and other payables.
 - (m) **financial liabilities** (excluding amounts shown under (l) and (p)).
 - (n) liabilities and assets for **current tax**.
 - (o) **deferred tax liabilities** and **deferred tax assets** (these shall always be classified as non-current).
 - (p) **provisions**.
 - (q) **non-controlling interest**, presented within **equity** separately from the equity attributable to the **owners** of the **parent**.
 - (r) equity attributable to the owners of the parent.
- 4.3 An entity shall present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's **financial position**.

CURRENT/NON-CURRENT DISTINCTION

- 4.4 An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 4.5–4.8.

CURRENT ASSETS

- 4.5 An entity shall classify an asset as current when:
- (a) it expects to realise the asset, or intends to sell or consume it, in the entity's normal operating cycle;

- (b) it holds the asset primarily for the purpose of trading;
 - (c) it expects to realise the asset within twelve months after the reporting date; or
 - (d) the asset is cash or a cash equivalent, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.
- 4.6 An entity shall classify all other assets as non-current. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

CURRENT LIABILITIES

- 4.7 An entity shall classify a liability as current when:
- (a) it expects to settle the liability in the entity's normal operating cycle;
 - (b) it holds the liability primarily for the purpose of trading;
 - (c) the liability is due to be settled within twelve months after the reporting date; or
 - (d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after reporting date.
- 4.8 An entity shall classify all other liabilities as non-current.

SEQUENCING OF ITEMS AND FORMAT OF ITEMS IN THE STATEMENT OF FINANCIAL POSITION

- 4.9 This FRS does not prescribe the sequence or format in which items are to be presented. Paragraph 4.2 simply provides a list of items that are sufficiently different in

nature or function to warrant separate presentation in the statement of financial position. In addition:

- (a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position, and
 - (b) the descriptions used and the sequencing of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position.
- 4.10 The judgement on whether additional items are presented separately is based on an assessment of all of the following:
- (a) the amounts, nature and liquidity of assets.
 - (b) the function of assets within the entity.
 - (c) the amounts, nature and timing of liabilities.

INFORMATION TO BE PRESENTED EITHER IN THE STATEMENT OF FINANCIAL POSITION OR IN THE NOTES

- 4.11 An entity shall disclose, either in the statement of financial position or in the notes, the following subclassifications of the line items presented:
- (a) property, plant and equipment in classifications appropriate to the entity.
 - (b) trade and other receivables showing separately amounts due from related parties, amounts due from other parties, and receivables arising from accrued income not yet billed.
 - (c) inventories, showing separately amounts of inventories:

- (i) held for sale in the ordinary course of business.
 - (ii) in the process of production for such sale.
 - (iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- (d) trade and other payables, showing separately amounts payable to trade suppliers, payable to related parties, deferred income and accruals.
- (e) provisions for **employee benefits** and other provisions.
- (f) classes of equity, such as paid-in capital, share premium, retained earnings and items of income and expense that, as required by this FRS, are recognised in other comprehensive income and presented separately in equity.
- 4.12 An entity with share capital shall disclose the following, either in the statement of financial position or in the notes:
- (a) for each class of share capital:
 - (i) the number of shares authorised.
 - (ii) the number of shares issued and fully paid, and issued but not fully paid.
 - (iii) par value per share, or that the shares have no par value.
 - (iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period.

- (v) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital.
 - (vi) shares in the entity held by the entity or by its subsidiaries or associates.
 - (vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts.
 - (b) a description of each reserve within equity.
- 4.13 An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.12(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.
- 4.14 If, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a group of assets and liabilities, the entity shall disclose the following information:
- (a) a description of the asset(s) or the group of assets and liabilities.
 - (b) a description of the facts and circumstances of the sale or plan.
 - (c) the carrying amount of the assets or, if the disposal involves a group of assets and liabilities, the carrying amounts of those assets and liabilities.

SECTION 5: STATEMENT OF COMPREHENSIVE INCOME AND INCOME STATEMENT

SCOPE OF THIS SECTION

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

PRESENTATION OF TOTAL COMPREHENSIVE INCOME

- 5.2 An entity shall present its total comprehensive income for a period either:
- (a) in a single **statement of comprehensive income**, in which case the statement of comprehensive income presents all items of income and expense recognised in the period, or
 - (b) in two statements—an **income statement** and a statement of comprehensive income—in which case the income statement presents all items of income and expense recognised in the period except those that are recognised in total comprehensive income outside of **profit or loss** as permitted or required by this FRS.
- 5.3 A change from the single-statement approach to the two-statement approach, or vice versa, is a change in accounting policy to which Section 10 *Accounting Policies, Estimates and Errors* applies.

Single-statement approach

- 5.4 Under the single-statement approach, the statement of comprehensive income shall include all items of income

and expense recognised in a period unless this FRS requires otherwise. This FRS provides different treatment for the following circumstances:

- (a) The effects of corrections of errors and changes in **accounting policies** are presented as retrospective adjustments of prior periods rather than as part of profit or loss in the period in which they arise (see Section 10).
 - (b) Three types of **other comprehensive income** are recognised as part of total comprehensive income, outside of profit or loss, when they arise:
 - (i) some **gains** and **losses** arising on translating the **financial statements** of a foreign operation (see Section 30 *Foreign Currency Translation*).
 - (ii) some actuarial gains and losses (see Section 28 *Employee Benefits*).
 - (iii) some changes in fair values of hedging instruments (see Section 12 *Other Financial Instruments Issues*).
- 5.5 As a minimum, an entity shall include, in the statement of comprehensive income, line items that present the following amounts for the period:
- (a) **revenue**.
 - (b) finance costs.
 - (c) share of the profit or loss of investments in **associates** (see Section 14 *Investments in Associates*) and **jointly controlled entities** (see Section 15 *Investments in Joint Ventures*) accounted for using the equity method.
 - (d) **tax expense** excluding tax allocated to items (e), (g) and (h) below (see paragraph 29.27).

- (e) a single amount comprising the total of
 - (i) the post-tax profit or loss of a **discontinued operation**, and
 - (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation.
 - (f) profit or loss (if an entity has no items of other comprehensive income, this line need not be presented).
 - (g) each item of other comprehensive income (see paragraph 5.4(b)) classified by nature (excluding amounts in (h)).
 - (h) share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method.
 - (i) total comprehensive income (if an entity has no items of other comprehensive income, it may use another term for this line such as profit or loss).
- 5.6 An entity shall disclose separately the following items in the statement of comprehensive income as allocations for the period:
- (a) profit or loss for the period attributable to
 - (i) **non-controlling interest**.
 - (ii) **owners** of the parent.
 - (b) total comprehensive income for the period attributable to
 - (i) **non-controlling interest**.

- (ii) owners of the parent.

Two-statement approach

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

Requirements applicable to both approaches

- 5.8 Under this FRS, the effects of corrections of errors and changes in accounting policies are presented as retrospective adjustments of prior periods rather than as part of profit or loss in the period in which they arise (see Section 10).
- 5.9 An entity shall present additional line items, headings and subtotals in the statement of comprehensive income (and in the income statement, if presented), when such presentation is relevant to an understanding of the entity's financial performance.
- 5.10 Ordinary activities are any activities which are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, these activities. Ordinary activities include any effects on the reporting entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events.
- 5.10A Extraordinary items are material items possessing a high degree of abnormality which arise from events or

transactions that fall outside the ordinary activities of the reporting entity and which are not expected to recur. They do not include the additional line items required by paragraph 5.9, nor do they include prior period items merely because they relate to a prior period.

ANALYSIS OF EXPENSES

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

Analysis by nature of expense

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

Analysis by function of expense

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

SECTION 6: STATEMENT OF CHANGES IN EQUITY AND STATEMENT OF INCOME AND RETAINED EARNINGS

SCOPE OF THIS SECTION

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

STATEMENT OF CHANGES IN EQUITY

Purpose

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

Information to be presented in the statement of changes in equity

- 6.3 An entity shall present a statement of changes in equity showing in the statement:
- (a) **total comprehensive income** for the period, showing separately the total amounts attributable to **owners** of the parent and to non-controlling interests.
 - (b) for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

- (c) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:
 - (i) profit or loss.
 - (ii) each item of other comprehensive income.
 - (iii) the amounts of investments by, and dividends and other distributions to, owners, showing separately issues of shares, treasury share transactions, dividends and other distributions to owners, and changes in ownership interests in subsidiaries that do not result in a loss of control.

STATEMENT OF INCOME AND RETAINED EARNINGS

Purpose

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

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

- 6.5 An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by Section 5 *Statement of Comprehensive Income and Income Statement*:
- (a) retained earnings at the beginning of the reporting period.
 - (b) dividends declared and paid or payable during the period.
 - (c) restatements of retained earnings for corrections of prior period errors.
 - (d) restatements of retained earnings for changes in accounting policy.
 - (e) retained earnings at the end of the reporting period.

SECTION 7: STATEMENT OF CASH FLOWS

SCOPE OF THIS SECTION

- 7.1 This section sets out the information that is to be presented in a **statement of cash flows** and how to present it. The statement of cash flows provides information about the changes in **cash** and **cash equivalents** of an entity for a reporting period, showing separately changes from **operating activities, investing activities** and **financing activities**.
- 7.1A A **parent** entity which presents **separate financial statements** with its **consolidated financial statements** may elect not to include a statement of cash flows in those separate financial statements.

CASH EQUIVALENTS

- 7.2 **Cash equivalents** are short-term, highly liquid investments held to meet short-term cash commitments rather than for investment or other purposes. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

INFORMATION TO BE PRESENTED IN THE STATEMENT OF CASH FLOWS

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

Operating activities

- 7.4 Operating activities are the principal **revenue**-producing activities of the entity. Therefore, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of **profit or loss**. Examples of cash flows from operating activities are:
- (a) cash receipts from the sale of goods and the rendering of services.
 - (b) cash receipts from royalties, fees, commissions and other revenue.
 - (c) cash payments to suppliers for goods and services.
 - (d) cash payments to and on behalf of employees.
 - (e) cash payments or refunds of income tax, unless they can be specifically identified with financing and investing activities.
 - (f) cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale.

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

Investing activities

- 7.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:
- (a) cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets and other long-term assets.
 - (b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets.
 - (c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments classified as cash equivalents or held for dealing or trading).
 - (d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading).
 - (e) cash advances and loans made to other parties.
 - (f) cash receipts from the repayment of advances and loans made to other parties.
 - (g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities.
 - (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

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

Financing activities

- 7.6 Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of an entity. Examples of cash flows arising from financing activities are:
- (a) cash proceeds from issuing shares or other equity instruments.
 - (b) cash payments to owners to acquire or redeem the entity's shares.
 - (c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings.
 - (d) cash repayments of amounts borrowed.
 - (e) cash payments by a lessee for the reduction of the outstanding liability relating to a **finance lease**.

REPORTING CASH FLOWS FROM OPERATING ACTIVITIES

- 7.7 An entity shall present cash flows from operating activities using either:
- (a) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows, or

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

Indirect method

- 7.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:
- (a) changes during the period in inventories and operating receivables and payables;
 - (b) non-cash items such as **depreciation, provisions, deferred tax**, accrued income (expenses) not yet received (paid) in cash, unrealised foreign currency gains and losses, undistributed profits of **associates**, and **non-controlling interests**; and
 - (c) all other items for which the cash effects relate to investing or financing.

Direct method

- 7.9 Under the direct method, net cash flow from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:
- (a) from the accounting records of the entity; or
 - (b) by adjusting sales, cost of sales and other items in the statement of comprehensive income (or the income statement, if presented) for:
 - (i) changes during the period in inventories and operating receivables and payables;
 - (ii) other non-cash items; and

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

REPORTING CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES

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

FOREIGN CURRENCY CASH FLOWS

- 7.11 An entity shall record cash flows arising from transactions in a foreign currency in the entity's **functional currency** by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.
- 7.12 The entity shall translate cash flows of a foreign subsidiary at the exchange rates between the entity's functional currency and the foreign currency at the dates of the cash flows.
- 7.13 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be presented in the statement of cash flows. Therefore, the entity shall remeasure cash and cash equivalents held during the reporting period (such as amounts of foreign currency held and foreign currency bank accounts) at period-end exchange rates. The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

INTEREST AND DIVIDENDS

- 7.14 An entity shall present separately cash flows from interest and dividends received and paid. The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.
- 7.15 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.
- 7.16 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

INCOME TAX

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

NON-CASH TRANSACTIONS

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

- 7.19 Many investing and financing activities do not have a direct impact on current cash flows even though they affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows because these items do not involve cash flows in the current period. Examples of non-cash transactions are:
- (a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease.
 - (b) the acquisition of an entity by means of an equity issue.
 - (c) the conversion of debt to equity.

COMPONENTS OF CASH AND CASH EQUIVALENTS

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

OTHER DISCLOSURES

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

SECTION 8: NOTES TO THE FINANCIAL STATEMENTS

SCOPE OF THIS SECTION

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

STRUCTURE OF THE NOTES

- 8.2 The notes shall:
- (a) present information about the basis of preparation of the financial statements and the specific **accounting policies** used, in accordance with paragraphs 8.5–8.7;
 - (b) disclose the information required by this FRS that is not presented elsewhere in the financial statements; and
 - (c) provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.
- 8.3 An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each

item in the financial statements to any related information in the notes.

- 8.4 An entity normally presents the notes in the following order:
- (a) a statement that the financial statements have been prepared in compliance with the FRSME (see paragraph 3.3);
 - (b) a summary of significant accounting policies applied (see paragraph 8.5);
 - (c) supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and
 - (d) any other disclosures.

DISCLOSURE OF ACCOUNTING POLICIES

- 8.5 An entity shall disclose the following in the summary of significant accounting policies:
- (a) the measurement basis (or bases) used in preparing the financial statements.
 - (b) the other accounting policies used that are relevant to an understanding of the financial statements.

INFORMATION ABOUT JUDGEMENTS

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

INFORMATION ABOUT KEY SOURCES OF ESTIMATION UNCERTAINTY

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

SECTION 9: CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

SCOPE OF THIS SECTION

- 9.1 This section applies where an entity is required to prepare group accounts (consolidated financial statements) in accordance with the Companies Act 2006 ('the Act'). An entity which is permitted by paragraph 1.1 to apply this FRS prepares group accounts in accordance with the Act. This section also includes guidance on **separate financial statements** and **combined financial statements**.

REQUIREMENT TO PRESENT CONSOLIDATED FINANCIAL STATEMENTS

- 9.2 A **parent** entity in the scope of this section shall present consolidated financial statements in which it consolidates its investments in **subsidiaries** in accordance with this FRS. Consolidated financial statements shall include all subsidiaries of the parent.
- 9.3 [not used]
- 9.4 A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. If an entity has created a special purpose entity (SPE) to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity (see paragraphs 9.10–9.12).
- 9.5 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. That presumption may be overcome in exceptional circumstances if it can be clearly demonstrated that such ownership does not constitute

control. Control also exists when the parent owns half or less of the voting power of an entity but it has:

- (a) power over more than half of the voting rights by virtue of an agreement with other investors;
- (b) power to govern the financial and operating policies of the entity under a statute or an agreement;
- (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or
- (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

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

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

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

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

SPECIAL PURPOSE ENTITIES

- 9.10 An entity may be created to accomplish a narrow objective (eg to effect a lease, undertake research and development activities or securitise financial assets). Such an SPE may take the form of a corporation, trust, partnership or unincorporated entity. Often, SPEs are created with legal arrangements that impose strict requirements over the operations of the SPE.
- 9.11 An entity shall prepare consolidated financial statements that include the entity and any SPEs that are controlled by that entity. In addition to the circumstances described in paragraph 9.5, the following circumstances may indicate that an entity controls an SPE (this is not an exhaustive list):
- (a) the activities of the SPE are being conducted on behalf of the entity according to its specific business needs.
 - (b) the entity has the ultimate decision-making powers over the activities of the SPE even if the day-to-day decisions have been delegated.
 - (c) the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE.
 - (d) the entity retains the majority of the residual or ownership risks related to the SPE or its assets.
- 9.12 Paragraphs 9.10 and 9.11 do not apply to post-employment benefit plans or other long-term employee benefit plans to which Section 28 *Employee Benefits* applies.

CONSOLIDATION PROCEDURES

- 9.13 The consolidated financial statements present financial information about the **group** as a single economic entity. In preparing consolidated financial statements, an entity shall:
- (a) combine the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses;
 - (b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary;
 - (c) measure and present **non-controlling interest** in the profit or loss of consolidated subsidiaries for the **reporting period** separately from the interest of the **owners** of the parent; and
 - (d) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interest in the net assets consists of:
 - (i) the amount of the non-controlling interest at the date of the original combination calculated in accordance with Section 19 *Business Combinations and Goodwill*, and
 - (ii) the non-controlling interest's share of changes in equity since the date of the combination.
- 9.14 The proportions of profit or loss and changes in equity allocated to the owners of the parent and to the non-controlling interest are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of options or convertible instruments.

Intragroup balances and transactions

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

Uniform reporting date

- 9.16 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same **reporting date** unless the provisions of Schedule 6, paragraph 2(2) of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 are applied.

Uniform accounting policies

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

Acquisition and disposal of subsidiaries

- 9.18 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date. The income and expenses of a subsidiary are included in the consolidated financial statements until the date on which

the parent ceases to control the subsidiary. The difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal, excluding the cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in equity in accordance with Section 30 *Foreign Currency Translation*, is recognised in the consolidated statement of comprehensive income (or the income statement, if presented) as the gain or loss on the disposal of the subsidiary.

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

Non-controlling interest in subsidiaries

- 9.20 An entity shall present non-controlling interest in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent, as required by paragraph 4.2(q).
- 9.21 An entity shall disclose non-controlling interest in the profit or loss of the group separately in the statement of comprehensive income, as required by paragraph 5.6 (or in the income statement, if presented, as required by paragraph 5.7).
- 9.22 Profit or loss and each component of other comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest. Total comprehensive

income shall be attributed to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interest having a deficit balance.

DISCLOSURES IN CONSOLIDATED FINANCIAL STATEMENTS

- 9.23 The following disclosures shall be made in consolidated financial statements:
- (a) the fact that the statements are consolidated financial statements.
 - (b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power.
 - (c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements.
 - (d) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.

SEPARATE FINANCIAL STATEMENTS

Presentation of separate financial statements

- 9.24 Paragraph 9.2 requires a parent to present consolidated financial statements. This FRS does not require presentation of **separate financial statements** for the parent entity or for the individual subsidiaries.
- 9.25 The financial statements of an entity that does not have a subsidiary are not separate financial statements. Therefore, an entity that is not a parent but is an investor in an associate or has a **venturer's** interest in a joint venture presents its

financial statements in compliance with Section 14 or Section 15, as appropriate. It may also elect to present separate financial statements.

Accounting policy election

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

- (a) at cost less impairment, or
- (b) at **fair value** with changes in fair value recognised in profit or loss.

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

Disclosures in separate financial statements

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

- (a) that the statements are separate financial statements, and
- (b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates,

and shall identify the consolidated financial statements or other primary financial statements to which they relate.

COMBINED FINANCIAL STATEMENTS

- 9.28 Combined financial statements are a single set of financial statements of two or more entities controlled by a single investor. This FRS does not require combined financial statements to be prepared.
- 9.29 If the investor prepares combined financial statements and describes them as conforming to the FRSME, those statements shall comply with all of the requirements of this FRS. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and property, plant and equipment shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances.

Disclosures in combined financial statements

- 9.30 The combined financial statements shall disclose the following:
- (a) the fact that the financial statements are combined financial statements.
 - (b) the reason why combined financial statements are prepared.
 - (c) the basis for determining which entities are included in the combined financial statements.
 - (d) the basis of preparation of the combined financial statements.
 - (e) the **related party** disclosures required by Section 33 *Related Party Disclosures*.

SECTION 10: ACCOUNTING POLICIES, ESTIMATES AND ERRORS

SCOPE OF THIS SECTION

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

SELECTION AND APPLICATION OF ACCOUNTING POLICIES

- 10.2 Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
- 10.3 If this FRS specifically addresses a transaction, other event or condition, an entity shall apply this FRS. However, the entity need not follow a requirement in this FRS if the effect of doing so would not be **material**.
- 10.4 If this FRS does not specifically address a transaction, other event or condition, an entity's management shall use its judgement in developing and applying an accounting policy that results in information that is:
- (a) **relevant** to the economic decision-making needs of users, and
 - (b) **reliable**, in that the financial statements:
 - (i) represent faithfully the **financial position**, **financial performance** and **cash flows** of the entity;

- (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, ie free from bias;
 - (iv) are prudent; and
 - (v) are complete in all material respects.
- 10.5 In making the judgement described in paragraph 10.4, management shall refer to, and consider the applicability of, the following sources in descending order:
- (a) the requirements and guidance in this FRS dealing with similar and related issues, and
 - (b) the definitions, **recognition** criteria and **measurement** concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.
- 10.6 In making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in **full IFRSs** dealing with similar and related issues.

CONSISTENCY OF ACCOUNTING POLICIES

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

CHANGES IN ACCOUNTING POLICIES

- 10.8 An entity shall change an accounting policy only if the change:
- (a) is required by changes to this FRS, or
 - (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.
- 10.9 The following are not changes in accounting policies:
- (a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring.
 - (b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material.
 - (c) a change to the cost model when a reliable measure of fair value is no longer available (or vice versa) for an asset that this FRS would otherwise require or permit to be measured at fair value.
- 10.10 If this FRS allows a choice of accounting treatment (including the measurement basis) for a specified transaction or other event or condition and an entity changes its previous choice, that is a change in accounting policy.

Applying changes in accounting policies

- 10.11 An entity shall account for changes in accounting policy as follows:
- (a) an entity shall account for a change in accounting policy resulting from a change in the requirements of

this FRS in accordance with the transitional provisions, if any, specified in that amendment;

- (b) when an entity has elected to follow IAS 39 *Financial Instruments: Recognition and Measurement* instead of following Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* as permitted by paragraph 11.2, and the requirements of IAS 39 change, the entity shall account for that change in accounting policy in accordance with the transitional provisions, if any, specified in the revised IAS 39; and
- (c) an entity shall account for all other changes in accounting policy **retrospectively** (see paragraph 10.12).

Retrospective application

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

DISCLOSURE OF A CHANGE IN ACCOUNTING POLICY

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

- (a) the nature of the change in accounting policy.
- (b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected.
- (c) the amount of the adjustment relating to periods before those presented, to the extent practicable.
- (d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

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

- (a) the nature of the change in accounting policy.
- (b) the reasons why applying the new accounting policy provides reliable and more relevant information.
- (c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately:
 - (i) for the current period;
 - (ii) for each prior period presented; and
 - (iii) in the aggregate for periods before those presented.
- (d) an explanation if it is impracticable to determine the amounts to be disclosed in (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

CHANGES IN ACCOUNTING ESTIMATES

- 10.15 A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.
- 10.16 An entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.17 applies, **prospectively** by including it in profit or loss in:
- (a) the period of the change, if the change affects that period only, or
 - (b) the period of the change and future periods, if the change affects both.
- 10.17 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Disclosure of a change in estimate

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

CORRECTIONS OF PRIOR PERIOD ERRORS

- 10.19 Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:
- (a) was available when financial statements for those periods were authorised for issue, and
 - (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
- 10.20 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.
- 10.21 To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its discovery by:
- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred, or
 - (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.
- 10.22 When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

Disclosure of prior period errors

- 10.23 An entity shall disclose the following about prior period errors:
- (a) the nature of the prior period error.
 - (b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected.
 - (c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented.
 - (d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

SECTION 11: BASIC FINANCIAL INSTRUMENTS

SCOPE OF SECTIONS 11 AND 12

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

ACCOUNTING POLICY CHOICE

- 11.2 An entity shall choose to apply either:
- (a) the provisions of both Section 11 and Section 12 in full, or
 - (b) the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* (as adopted in the EU) and the disclosure requirements of Sections 11 and 12.

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

INTRODUCTION TO SECTION 11

- 11.3 A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.
- 11.4 Section 11 requires an amortised cost model for all basic financial instruments except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are **publicly traded** or whose fair value can otherwise be measured reliably.
- 11.5 Basic financial instruments within the scope of Section 11 are those that satisfy the conditions in paragraph 11.8. Examples of financial instruments that normally satisfy those conditions include:
- (a) cash.
 - (b) demand and fixed-term deposits when the entity is the depositor, eg bank accounts.
 - (c) commercial paper and commercial bills held.
 - (d) accounts, notes and loans receivable and payable.
 - (e) bonds and similar debt instruments.
 - (f) investments in non-convertible preference shares and non-puttable ordinary and preference shares.
 - (g) commitments to receive a loan if the commitment cannot be net settled in cash.

- 11.6 Examples of financial instruments that do not normally satisfy the conditions in paragraph 11.8, and are therefore within the scope of Section 12, include:
- (a) asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables.
 - (b) options, rights, warrants, futures contracts, forward contracts and interest rate swaps that can be settled in cash or by exchanging another financial instrument.
 - (c) financial instruments that qualify and are designated as hedging instruments in accordance with the requirements in Section 12.
 - (d) commitments to make a loan to another entity.
 - (e) commitments to receive a loan if the commitment can be net settled in cash.

SCOPE OF SECTION 11

- 11.7 Section 11 applies to all financial instruments meeting the conditions of paragraph 11.8 except for the following:
- (a) investments in **subsidiaries, associates** and **joint ventures** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Investments in Joint Ventures*.
 - (b) financial instruments that meet the definition of an entity's own equity (see Section 22 *Liabilities and Equity* and Section 26 *Share-based Payment*).
 - (c) leases, to which Section 20 *Leases* applies. However, the derecognition requirements in paragraphs 11.33–11.38 apply to derecognition of lease receivables recognised by a lessor and lease payables recognised by a lessee.

Also, Section 12 may apply to leases with characteristics specified in paragraph 12.3(f).

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

BASIC FINANCIAL INSTRUMENTS

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

- (a) cash.
- (b) a debt instrument (such as an account, note, or loan receivable or payable) that meets the conditions in paragraph 11.9.
- (c) a commitment to receive a loan that:
 - (i) cannot be settled net in cash, and
 - (ii) when the commitment is executed, is expected to meet the conditions in paragraph 11.9.
- (d) an investment in non-convertible preference shares and non-puttable ordinary shares or preference shares.

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

- (a) Returns to the holder are
 - (i) a fixed amount;
 - (ii) a fixed rate of return over the life of the instrument;

- (iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR); or
 - (iv) some combination of such fixed rate and variable rates (such as LIBOR plus 200 basis points), provided that both the fixed and variable rates are positive (eg an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion). For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.
- (b) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision.
 - (c) Contractual provisions that permit the issuer (the debtor) to prepay a debt instrument or permit the holder (the creditor) to put it back to the issuer before maturity are not contingent on future events.
 - (d) There are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).
- 11.10 Examples of financial instruments that would normally satisfy the conditions in paragraph 11.9 are:
- (a) trade accounts and notes receivable and payable, and loans from banks or other third parties.
 - (b) accounts payable in a foreign currency. However, any change in the account payable because of a change in

the exchange rate is recognised in profit or loss as required by paragraph 30.10.

- (c) loans to or from subsidiaries or associates that are due on demand.
 - (d) a debt instrument that would become immediately receivable if the issuer defaults on an interest or principal payment (such a provision does not violate the conditions in paragraph 11.9).
- 11.11 Examples of financial instruments that do not satisfy the conditions in paragraph 11.9 (and are therefore within the scope of Section 12) include:
- (a) an investment in another entity's equity instruments other than non-convertible preference shares and non-puttable ordinary and preference shares (see paragraph 11.8(d)).
 - (b) an interest rate swap that returns a cash flow that is positive or negative, or a forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow, because such swaps and forwards do not meet the condition in paragraph 11.9(a).
 - (c) options and forward contracts, because returns to the holder are not fixed and the condition in paragraph 11.9(a) is not met.
 - (d) investments in convertible debt, because the return to the holder can vary with the price of the issuer's equity shares rather than just with market interest rates.
 - (e) a loan receivable from a third party that gives the third party the right or obligation to prepay if the applicable taxation or accounting requirements change, because

such a loan does not meet the condition in paragraph 11.9(c).

INITIAL RECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

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

INITIAL MEASUREMENT

- 11.13 When a financial asset or financial liability is recognised initially, an entity shall measure it at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction. A financing transaction may take place in connection with the sale of goods or services, for example, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Examples – financial assets

- 1 For a long-term loan made to another entity, a receivable is recognised at the present value of cash receivable (including interest payments and repayment of principal) from that entity.
- 2 For goods sold to a customer on short-term credit, a receivable is recognised at the undiscounted amount of cash receivable from that entity, which is normally the invoice price.

Examples – financial assets

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

Examples – financial liabilities

- 1 For a loan received from a bank, a payable is recognised initially at the present value of cash payable to the bank (eg including interest payments and repayment of principal).
- 2 For goods purchased from a supplier on short-term credit, a payable is recognised at the undiscounted amount owed to the supplier, which is normally the invoice price.

SUBSEQUENT MEASUREMENT

- 11.14 At the end of each **reporting period**, an entity shall measure financial instruments as follows, without any deduction for transaction costs the entity may incur on sale or other disposal:
- (a) Debt instruments that meet the conditions in paragraph 11.8(b) shall be measured at **amortised cost** using the **effective interest method**. Paragraphs 11.15–11.20 provide guidance on determining amortised cost using the effective interest method. Debt instruments that are classified as current assets or current liabilities shall be measured at the undiscounted amount of the cash or other consideration expected to be paid or received (ie

net of impairment—see paragraphs 11.21–11.26) unless the arrangement constitutes, in effect, a financing transaction (see paragraph 11.13). If the arrangement constitutes a financing transaction, the entity shall measure the debt instrument at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

- (b) Commitments to receive a loan that meet the conditions in paragraph 11.8(c) shall be measured at cost (which sometimes is nil) less impairment.
- (c) Investments in non-convertible preference shares and non-puttable ordinary or preference shares that meet the conditions in paragraph 11.8(d) shall be measured as follows (paragraphs 11.27–11.33 provide guidance on fair value):
 - (i) if the shares are publicly traded or their fair value can otherwise be measured reliably, the investment shall be measured at fair value with changes in fair value recognised in profit or loss.
 - (ii) all other such investments shall be measured at cost less impairment.

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

Amortised cost and effective interest method

- 11.15 The amortised cost of a financial asset or financial liability at each reporting date is the net of the following amounts:
- (a) the amount at which the financial asset or financial liability is measured at initial recognition,
 - (b) minus any repayments of the principal,

- (c) plus or minus the cumulative amortisation using the effective interest method of any difference between the amount at initial recognition and the maturity amount,
- (d) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Financial assets and financial liabilities that have no stated interest rate and are classified as current assets or current liabilities are initially measured at an undiscounted amount in accordance with paragraph 11.14(a). Therefore, (c) above does not apply to them.

- 11.16 The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the carrying amount of the financial asset or financial liability. The effective interest rate is determined on the basis of the carrying amount of the financial asset or liability at initial recognition. Under the effective interest method:
- (a) the amortised cost of a financial asset (liability) is the present value of future cash receipts (payments) discounted at the effective interest rate, and
 - (b) the interest expense (income) in a period equals the carrying amount of the financial liability (asset) at the beginning of a period multiplied by the effective interest rate for the period.
- 11.17 When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (eg prepayment, call and similar options) and known credit losses that have been incurred,

but it shall not consider possible future credit losses not yet incurred.

- 11.18 When calculating the effective interest rate, an entity shall amortise any related fees, finance charges paid or received (such as ‘points’), transaction costs and other premiums or discounts over the expected life of the instrument, except as follows. The entity shall use a shorter period if that is the period to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date.
- 11.19 For variable rate financial assets and variable rate financial liabilities, periodic re-estimation of cash flows to reflect changes in market rates of interest alters the effective interest rate. If a variable rate financial asset or variable rate financial liability is recognised initially at an amount equal to the principal receivable or payable at maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.
- 11.20 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity shall recalculate the carrying amount by computing the present value of estimated future cash flows at the financial instrument’s original effective interest rate. The entity shall recognise the adjustment as income or expense in profit or loss at the date of the revision.

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

On 1 January 20X0, an entity acquires a bond for Currency Units (CU)900, incurring transaction costs of CU50. Interest of CU40 is receivable annually, in arrears, over the next five years (31 December 20X0–31 December 20X4). The bond has a mandatory redemption of CU1100 on 31 December 20X4.

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

* The effective interest rate of 6.9583 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount:
 $40/(1.069583)^1 + 40/(1.069583)^2 + 40/(1.069583)^3 + 40/(1.069583)^4 + 1,140/(1.069583)^5 = 950$

Impairment of financial instruments measured at cost or amortised cost

Recognition

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

- 11.22 Objective evidence that a financial asset or group of assets is impaired includes observable data that come to the attention of the holder of the asset about the following loss events:
- (a) significant financial difficulty of the issuer or obligor.
 - (b) a breach of contract, such as a default or delinquency in interest or principal payments.
 - (c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider.
 - (d) it has become **probable** that the debtor will enter bankruptcy or other financial reorganisation.
 - (e) observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.
- 11.23 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates.
- 11.24 An entity shall assess the following financial assets individually for impairment:
- (a) all equity instruments regardless of significance, and
 - (b) other financial assets that are individually significant.

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

Measurement

- 11.25 An entity shall measure an impairment loss on the following instruments measured at cost or amortised cost as follows:
- (a) for an instrument measured at amortised cost in accordance with paragraph 11.14(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. If such a financial instrument has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.
 - (b) for an instrument measured at cost less impairment in accordance with paragraph 11.14(b) and (c)(ii) the impairment loss is the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold at the reporting date.

Reversal

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

shall recognise the amount of the reversal in profit or loss immediately.

Fair value

11.27 Paragraph 11.14(c)(i) requires an investment in ordinary shares or preference shares to be measured at fair value if the fair value of the shares can be measured reliably. An entity shall use the following hierarchy to estimate the fair value of the shares:

- (a) The best evidence of fair value is a quoted price for an identical asset in an active market. This is usually the current bid price.
- (b) When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (eg because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.
- (c) If the market for the asset is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using a valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Other sections of this FRS make reference to the fair value guidance in paragraphs 11.27–11.32, including Section 12, Section 14, Section 15 and Section 16 *Investment Property*. In applying that guidance to assets covered by those sections, the reference to ordinary shares or preference

shares in this paragraph should be read to include the types of assets covered by those sections.

Valuation technique

- 11.28 Valuation techniques include using recent arm's length market transactions for an identical asset between knowledgeable, willing parties, if available, reference to the current fair value of another asset that is substantially the same as the asset being measured, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the asset and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.
- 11.29 The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-determined inputs. A valuation technique would be expected to arrive at a reliable estimate of the fair value if:
- (a) it reasonably reflects how the market could be expected to price the asset, and
 - (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk return factors inherent in the asset.

No active market: equity instruments

- 11.30 The fair value of investments in assets that do not have a quoted market price in an active market is reliably measurable if:
- (a) the variability in the range of reasonable fair value estimates is not significant for that asset, or
 - (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.
- 11.31 There are many situations in which the variability in the range of reasonable fair value estimates of assets that do not have a quoted market price is likely not to be significant. Normally it is possible to estimate the fair value of an asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the asset at fair value.
- 11.32 If a reliable measure of fair value is no longer available for an asset measured at fair value (eg an equity instrument measured at fair value through profit or loss), its carrying amount at the last date the asset was reliably measurable becomes its new cost. The entity shall measure the asset at this cost amount less impairment until a reliable measure of fair value becomes available.

DERECOGNITION OF A FINANCIAL ASSET

- 11.33 An entity shall derecognise a financial asset only when:
- (a) the contractual rights to the cash flows from the financial asset expire or are settled, or
 - (b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or

- (c) the entity, despite having retained some significant risks and rewards of ownership, has transferred control of the asset to another party and the other party has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer. In this case, the entity shall:
 - (i) derecognise the asset, and
 - (ii) recognise separately any rights and obligations retained or created in the transfer.

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

- 11.34 If a transfer does not result in derecognition because the entity has retained significant risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. The asset and liability shall not be offset. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.
- 11.35 If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:

- (a) If the transferee has the right by contract or custom to sell or repledge the collateral, the transferor shall reclassify that asset in its statement of financial position (eg as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.
- (b) If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.
- (c) If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.
- (d) Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.

Example – transfer that qualifies for derecognition

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

Example – transfer that does not qualify for derecognition

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

DERECOGNITION OF A FINANCIAL LIABILITY

- 11.36 An entity shall derecognise a financial liability (or a part of a financial liability) only when it is extinguished—ie when the obligation specified in the contract is discharged, is cancelled or expires.
- 11.37 If an existing borrower and lender exchange financial instruments with substantially different terms, the entities shall account for the transaction as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, an entity shall account for a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) as an extinguishment of the original financial liability and the recognition of a new financial liability.
- 11.38 The entity shall recognise in profit or loss any difference between the carrying amount of the financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed.

DISCLOSURES

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

Disclosure of accounting policies for financial instruments

- 11.40 In accordance with paragraph 8.5, an entity shall disclose, in the summary of significant accounting policies, the measurement basis (or bases) used for financial instruments and the other accounting policies used for

financial instruments that are relevant to an understanding of the financial statements.

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

- 11.41 An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities at the reporting date, in total, either in the statement of financial position or in the notes:
- (a) financial assets measured at fair value through profit or loss (paragraph 11.14(c)(i) and paragraphs 12.8 and 12.9).
 - (b) financial assets that are debt instruments measured at amortised cost (paragraph 11.14(a)).
 - (c) financial assets that are equity instruments measured at cost less impairment (paragraph 11.14(c)(ii) and paragraphs 12.8 and 12.9).
 - (d) financial liabilities measured at fair value through profit or loss (paragraphs 12.8 and 12.9). Financial liabilities that are not held as part of a trading portfolio and are not derivatives shall be shown separately.
 - (e) financial liabilities measured at amortised cost (paragraph 11.14(a)).
 - (f) loan commitments measured at cost less impairment (paragraph 11.14(b)).
- 11.42 An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment

schedule, and restrictions that the debt instrument imposes on the entity).

- 11.43 For all financial assets and financial liabilities measured at fair value, the entity shall disclose the basis for determining fair value, eg quoted market price in an active market or a valuation technique. When a valuation technique is used, the entity shall disclose the assumptions applied in determining fair value for each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.
- 11.44 If a reliable measure of fair value is no longer available for an equity instrument measured at fair value through profit or loss, the entity shall disclose that fact.

Derecognition

- 11.45 If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.33–11.35), the entity shall disclose the following for each class of such financial assets:
- (a) the nature of the assets.
 - (b) the nature of the risks and rewards of ownership to which the entity remains exposed.
 - (c) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

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

- (a) the carrying amount of the financial assets pledged as collateral.
- (b) the terms and conditions relating to its pledge.

Defaults and breaches on loans payable

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

- (a) details of that breach or default.
- (b) the carrying amount of the related loans payable at the reporting date.
- (c) whether the breach or default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

Items of income, expense, gains or losses

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

- (a) income, expense, gains or losses, including changes in fair value, recognised on:
 - (i) financial assets measured at fair value through profit or loss.
 - (ii) financial liabilities measured at fair value through profit or loss (with separate disclosure of movements on those which are not held as part of a trading portfolio and are not derivatives).
 - (iii) financial assets measured at amortised cost.

- (iv) financial liabilities measured at amortised cost.
- (b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not measured at fair value through profit or loss.
- (c) the amount of any impairment loss for each class of financial asset.

Financial instruments at fair value

11.48A The following disclosures are required only for financial instruments at fair value that are not equity investments, are not held as part of a trading portfolio and are not derivatives:

- (a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, determined either:
 - (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
 - (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.
- (b) the method used to establish the amount of change attributable to changes in own credit risk, or, if the change cannot be measured reliably or is not material, that fact.
- (c) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

- (d) if an instrument contains both a liability and an equity feature, and the instrument has multiple features that substantially modify the cash flows and the values of those features are interdependent (such as a callable convertible debt instrument), the existence of those features.
- (e) any difference between the fair value at initial recognition and the amount that would be determined at that date using a valuation technique, and the amount recognised in profit or loss.
- (f) information that enables users of the entity's financial statements to evaluate the nature and extent of relevant risks arising from financial instruments to which the entity is exposed at the end of the reporting period. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk. The disclosure should include both the entity's exposure to each type of risk and how it manages those risks.

SECTION 12: OTHER FINANCIAL INSTRUMENTS ISSUES

SCOPE OF SECTIONS 11 AND 12

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

ACCOUNTING POLICY CHOICE

- 12.2 An entity shall choose to apply either:
- (a) the provisions of both Section 11 and Section 12 in full, or
 - (b) the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* and the disclosure requirements of Sections 11 and 12

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

SCOPE OF SECTION 12

- 12.3 Section 12 applies to all financial instruments except the following:
- (a) those covered by Section 11.
 - (b) interests in subsidiaries (see Section 9 *Consolidated and Separate Financial Statements*), associates (see Section 14 *Investments in Associates*) and joint ventures (see Section 15 *Investments in Joint Ventures*).
 - (c) employers' rights and obligations under employee benefit plans (see Section 28 *Employee Benefits*).
 - (d) rights under insurance contracts unless the insurance contract could result in a loss to either party as a result of contractual terms that are unrelated to:
 - (i) changes in the insured risk;
 - (ii) changes in foreign exchange rates; or
 - (iii) a default by one of the counterparties.
 - (e) financial instruments that meet the definition of an entity's own equity (see Section 22 *Equity* and Section 26 *Share-based Payment*).
 - (f) leases (see Section 20 *Leases*) unless the lease could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:
 - (i) changes in the price of the leased asset;
 - (ii) changes in foreign exchange rates; or
 - (iii) a default by one of the counterparties.

- (g) contracts for contingent consideration in a business combination (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.
- 12.4 Most contracts to buy or sell a non-financial item such as a commodity, inventory, or property, plant and equipment are excluded from this section because they are not financial instruments. However, this section applies to all contracts that impose risks on the buyer or seller that are not typical of contracts to buy or sell tangible assets. For example, this section applies to contracts that could result in a loss to the buyer or seller as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties.
- 12.5 In addition to the contracts described in paragraph 12.4, this section applies to contracts to buy or sell non-financial items if the contract can be settled net in cash or another financial instrument, or by exchanging financial instruments as if the contracts were financial instruments, with the following exception: contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements are not financial instruments for the purposes of this section.

INITIAL RECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

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

INITIAL MEASUREMENT

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

SUBSEQUENT MEASUREMENT

- 12.8 At the end of each **reporting period**, an entity shall measure all financial instruments within the scope of Section 12 at fair value and recognise changes in fair value in profit or loss, except as follows: equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably, and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, shall be measured at cost less impairment.
- 12.8A For financial instruments in the scope of this section that are not held for trading and are not derivative instruments, an entity shall provide additional disclosures as set out in paragraph 11.48A.
- 12.9 If a reliable measure of fair value is no longer available for an equity instrument that is not publicly traded but is measured at fair value through profit or loss, its fair value at the last date the instrument was reliably measurable is treated as the cost of the instrument. The entity shall measure the instrument at this cost amount less impairment until a reliable measure of fair value becomes available.

FAIR VALUE

- 12.10 An entity shall apply the guidance on fair value in paragraphs 11.27–11.32 to fair value measurements in accordance with this section as well as for fair value measurements in accordance with Section 11.
- 12.11 The fair value of a financial liability that is due on demand is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.
- 12.12 An entity shall not include transaction costs in the initial measurement of financial assets and liabilities that will be measured subsequently at fair value through profit or loss. If payment for an asset is deferred or is financed at a rate of

interest that is not a market rate, the entity shall initially measure the asset at the present value of the future payments discounted at a market rate of interest.

IMPAIRMENT OF FINANCIAL INSTRUMENTS MEASURED AT COST OR AMORTISED COST

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

DERECOGNITION OF A FINANCIAL ASSET OR FINANCIAL LIABILITY

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

HEDGE ACCOUNTING

- 12.15 If specified criteria are met, an entity may designate a hedging relationship between a **hedging instrument** and a **hedged item** in such a way as to qualify for hedge accounting. Hedge accounting permits the gain or loss on the hedging instrument and on the hedged item to be recognised in profit or loss at the same time.
- 12.16 To qualify for hedge accounting, an entity shall comply with all of the following conditions:
- (a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.
 - (b) the hedged risk is one of the risks specified in paragraph 12.17.

- (c) the hedging instrument is as specified in paragraph 12.18.
 - (d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.
- 12.17 This FRS permits hedge accounting only for the following risks:
- (a) interest rate risk of a debt instrument measured at amortised cost.
 - (b) foreign exchange or interest rate risk in a firm commitment or a **highly probable forecast transaction**.
 - (c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity.
 - (d) foreign exchange risk in a net investment in a foreign operation.

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

carrying amount of the payable relating to the change in the exchange rate would be recognised in profit or loss and should offset each other except to the extent of the difference between the spot rate (at which the liability is measured) and the forward rate (at which the swap is measured).

- 12.18 This FRS permits hedge accounting only if the hedging instrument has all of following terms and conditions:
- (a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 12.17 that is designated as the hedged risk.
 - (b) it involves a party external to the reporting entity (ie external to the **group**, segment or individual entity being reported on).
 - (c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item.
 - (d) it has a specified maturity date not later than
 - (i) the maturity of the financial instrument being hedged,
 - (ii) the expected settlement of the commodity purchase or sale commitment, or
 - (iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.
 - (e) it has no prepayment, early termination or extension features.

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

- 12.19 If the conditions in paragraph 12.16 are met and the hedged risk is the exposure to a fixed interest rate risk of a debt instrument measured at amortised cost or the commodity price risk of a commodity that it holds, the entity shall:
- (a) recognise the hedging instrument as an asset or liability and the change in the fair value of the hedging instrument in profit or loss, and
 - (b) recognise the change in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item.
- 12.20 If the hedged risk is the fixed interest rate risk of a debt instrument measured at amortised cost, the entity shall recognise the periodic net cash settlements on the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.
- 12.21 The entity shall discontinue the hedge accounting specified in paragraph 12.19 if:
- (a) the hedging instrument expires or is sold or terminated;
 - (b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 12.16; or
 - (c) the entity revokes the designation.
- 12.22 If hedge accounting is discontinued and the hedged item is an asset or liability carried at amortised cost that has not been derecognised, any gains or losses recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged instrument.

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

- 12.23 If the conditions in paragraph 12.16 are met and the hedged risk is:
- (a) the variable interest rate risk in a debt instrument measured at amortised cost,
 - (b) the foreign exchange risk in a **firm commitment** or a highly probable forecast transaction,
 - (c) the commodity price risk in a firm commitment or highly probable forecast transaction, or
 - (d) the foreign exchange risk in a net investment in a foreign operation,

the entity shall recognise in other comprehensive income the portion of the change in the fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item. The entity shall recognise in profit or loss any excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows (sometimes called hedge ineffectiveness). The hedging gain or loss recognised in other comprehensive income shall be reclassified to profit or loss when the hedged item is recognised in profit or loss or when the hedging relationship ends.

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

- 12.25 The entity shall discontinue the hedge accounting specified in paragraph 12.23 if:
- (a) the hedging instrument expires or is sold or terminated;
 - (b) the hedge no longer meets the criteria for hedge accounting in paragraph 12.16;
 - (c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable; or
 - (d) the entity revokes the designation.

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

DISCLOSURES

- 12.26 An entity applying this section shall make all of the disclosures required in Section 11 incorporating in those disclosures financial instruments that are within the scope of this section as well as those within the scope of Section 11. In addition, if the entity uses hedge accounting, it shall make the additional disclosures in paragraphs 12.27–12.29.
- 12.27 An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 12.17:
- (a) a description of the hedge.
 - (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date.

- (c) the nature of the risks being hedged, including a description of the hedged item.
- 12.28 If an entity uses hedge accounting for a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 12.19–12.22) it shall disclose the following:
- (a) the amount of the change in fair value of the hedging instrument recognised in profit or loss.
 - (b) the amount of the change in fair value of the hedged item recognised in profit or loss.
- 12.29 If an entity uses hedge accounting for a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation (paragraphs 12.23–12.25) it shall disclose the following:
- (a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss.
 - (b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur.
 - (c) the amount of the change in fair value of the hedging instrument that was recognised in other comprehensive income during the period (paragraph 12.23).
 - (d) the amount that was reclassified from other comprehensive income to profit or loss for the period (paragraphs 12.23 and 12.25).
 - (e) the amount of any excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows that was recognised in profit or loss (paragraph 12.24).

SECTION 13: INVENTORIES

SCOPE OF THIS SECTION

- 13.1 This section sets out the principles for recognising and measuring **inventories**. Inventories are **assets**:
- (a) held for sale in the ordinary course of business;
 - (b) in the process of production for such sale; or
 - (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- 13.2 This section applies to all inventories, except:
- (a) work in progress arising under construction contracts, including directly related service contracts (see Section 23 *Revenue*).
 - (b) financial instruments (see Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*).
 - (c) **biological assets** related to agricultural activity and **agricultural produce** at the point of harvest (see Section 34 *Specialised Activities*).
- 13.3 This section does not apply to the measurement of inventories held by:
- (a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at **fair value** less costs to sell through profit or loss, or
 - (b) commodity brokers and dealers that measure their inventories at fair value less costs to sell through profit or loss.

MEASUREMENT OF INVENTORIES

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

COST OF INVENTORIES

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

COSTS OF PURCHASE

- 13.6 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
- 13.7 An entity may purchase inventories on deferred settlement terms. In some cases, the arrangement effectively contains an unstated financing element, for example, a difference between the purchase price for normal credit terms and the deferred settlement amount. In these cases, the difference is recognised as interest expense over the period of the financing and is not added to the cost of the inventories.

COSTS OF CONVERSION

- 13.8 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and

maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

ALLOCATION OF PRODUCTION OVERHEADS

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

JOINT PRODUCTS AND BY-PRODUCTS

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

entity shall measure them at selling price less costs to complete and sell and deduct this amount from the cost of the main product. As a result, the **carrying amount** of the main product is not materially different from its cost.

OTHER COSTS INCLUDED IN INVENTORIES

- 13.11 An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.
- 13.12 Paragraph 12.19(b) provides that, in some circumstances, the change in the fair value of the hedging instrument in a hedge of fixed interest rate risk or commodity price risk of a commodity held adjusts the carrying amount of the commodity.

COSTS EXCLUDED FROM INVENTORIES

- 13.13 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:
- (a) abnormal amounts of wasted materials, labour or other production costs.
 - (b) storage costs, unless those costs are necessary during the production process before a further production stage.
 - (c) administrative overheads that do not contribute to bringing inventories to their present location and condition.
 - (d) selling costs.

COST OF INVENTORIES OF A SERVICE PROVIDER

- 13.14 To the extent that service providers have inventories, they measure them at the costs of their production. These costs

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

COST OF AGRICULTURAL PRODUCE HARVESTED FROM BIOLOGICAL ASSETS

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

TECHNIQUES FOR MEASURING COST, SUCH AS STANDARD COSTING, RETAIL METHOD AND MOST RECENT PURCHASE PRICE

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

COST FORMULAS

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

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

IMPAIRMENT OF INVENTORIES

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

RECOGNITION AS AN EXPENSE

- 13.20 When inventories are sold, the entity shall recognise the carrying amount of those inventories as an expense in the period in which the related revenue is recognised.
- 13.21 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are accounted for subsequently in accordance with the section of this FRS relevant to that type of asset.

DISCLOSURES

13.22 An entity shall disclose the following:

- (a) the **accounting policies** adopted in measuring inventories, including the cost formula used.
- (b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity.
- (c) the amount of inventories recognised as an expense during the period.
- (d) impairment losses recognised or reversed in profit or loss in accordance with Section 27.
- (e) the total carrying amount of inventories pledged as security for liabilities.

SECTION 14: INVESTMENTS IN ASSOCIATES

SCOPE OF THIS SECTION

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

ASSOCIATES DEFINED

- 14.2 An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a **subsidiary** nor an interest in a **joint venture**.
- 14.3 Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not **control** or **joint control** over those policies.
- (a) If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.
 - (b) Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.
 - (c) A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

MEASUREMENT—ACCOUNTING POLICY ELECTION

- 14.4 An investor which is not a parent but that has an investment in one or more associates shall account for all of its investments in associates using the cost model in paragraph 14.5.
- 14.4A An investor which is a parent shall, in its consolidated financial statements, account for all of its investments in associates using the equity method in paragraph 14.8.

Cost model

- 14.5 An investor which is not a parent shall measure its investments in associates at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.
- 14.6 The investor shall recognise dividends and other distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.
- 14.7 [not used]

Equity method

- 14.8 Under the equity method of accounting, an equity investment is initially recognised at the transaction price (including transaction costs) and is subsequently adjusted to reflect the investor's share of the **profit or loss** and other comprehensive income of the associate.
- (a) *Distributions and other adjustments to carrying amount.* Distributions received from the associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be required as a consequence

of changes in the associate's equity arising from items of **other comprehensive income**.

- (b) *Potential voting rights*. Although potential voting rights are considered in deciding whether significant influence exists, an investor shall measure its share of profit or loss of the associate and its share of changes in the associate's equity on the basis of present ownership interests. Those measurements shall not reflect the possible exercise or conversion of potential voting rights.
- (c) *Implicit goodwill and fair value adjustments*. On acquisition of the investment in an associate, an investor shall account for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate in accordance with paragraphs 19.22–19.24. An investor shall adjust its share of the associate's profits or losses after acquisition to account for additional depreciation or amortisation of the associate's depreciable or amortisable assets (including goodwill) on the basis of the excess of their fair values over their carrying amounts at the time the investment was acquired.
- (d) *Impairment*. If there is an indication that an investment in an associate may be impaired, an investor shall test the entire carrying amount of the investment for impairment in accordance with Section 27 as a single asset. Any goodwill included as part of the carrying amount of the investment in the associate is not tested separately for impairment but, rather, as part of the test for impairment of the investment as a whole.
- (e) *Investor's transactions with associates*. If an associate is accounted for using the equity method, the investor shall eliminate unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions to the extent of the

investor's interest in the associate. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.

- (f) *Date of associate's financial statements.* In applying the equity method, the investor shall use the financial statements of the associate as of the same date as the financial statements of the investor unless it is **impracticable** to do so. If it is impracticable, the investor shall use the most recent available financial statements of the associate, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends.
- (g) *Associate's accounting policies.* If the associate uses accounting policies that differ from those of the investor, the investor shall adjust the associate's financial statements to reflect the investor's accounting policies for the purpose of applying the equity method unless it is impracticable to do so.
- (h) *Losses in excess of investment.* If an investor's share of losses of an associate equals or exceeds the carrying amount of its investment in the associate, the investor shall discontinue recognising its share of further losses. After the investor's interest is reduced to zero, the investor shall recognise additional losses by a provision (see Section 21 *Provisions and Contingencies*) only to the extent that the investor has incurred legal or constructive obligations or has made payments on behalf of the associate. If the associate subsequently reports profits, the investor shall resume recognising its share of those profits only after its share of the profits equals the share of losses not recognised.
- (i) *Discontinuing the equity method.* An investor shall cease using the equity method from the date that significant influence ceases.

- (i) If the associate becomes a subsidiary or joint venture, the investor shall remeasure its previously held equity interest to fair value and recognise the resulting gain or loss, if any, in profit or loss.
- (ii) If an investor loses significant influence over an associate as a result of a full or partial disposal, it shall derecognise that associate and recognise in profit or loss the difference between, on the one hand, the sum of the proceeds received plus the fair value of any retained interest and, on the other hand, the carrying amount of the investment in the associate at the date significant influence is lost. Thereafter, the investor shall account for any retained interest using Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*, as appropriate.
- (iii) If an investor loses significant influence for reasons other than a partial disposal of its investment, the investor shall regard the carrying amount of the investment at that date as a new cost basis and shall account for the investment using Sections 11 and 12, as appropriate.

Fair value model

14.9 [not used].

14.10 [not used].

FINANCIAL STATEMENT PRESENTATION

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

DISCLOSURES

- 14.12 An investor in an associate shall disclose the following:
- (a) its **accounting policy** for investments in associates.
 - (b) the **carrying amount** of investments in associates (see paragraph 4.2(j)).
 - (c) the fair value of investments in associates accounted for using the equity method for which there are published price quotations.
- 14.13 For investments in associates accounted for by the cost model, an investor shall disclose the amount of dividends and other distributions recognised as income.
- 14.14 For investments in associates accounted for by the equity method, an investor shall disclose separately its share of the profit or loss of such associates and its share of any **discontinued operations** of such associates.
- 14.15 [not used]

SECTION 15: INVESTMENTS IN JOINT VENTURES

SCOPE OF THIS SECTION

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

JOINT VENTURES DEFINED

- 15.2 Joint control is the contractually agreed sharing of **control** over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).
- 15.3 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or **jointly controlled entities**.

JOINTLY CONTROLLED OPERATIONS

- 15.4 The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The

joint venture agreement usually provides a means by which the revenue from the sale of the joint product and any expenses incurred in common are shared among the venturers.

- 15.5 In respect of its interests in jointly controlled operations, a venturer shall recognise in its financial statements:
- (a) the assets that it controls and the liabilities that it incurs, and
 - (b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

JOINTLY CONTROLLED ASSETS

- 15.6 Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.
- 15.7 In respect of its interest in a jointly controlled asset, a venturer shall recognise in its financial statements:
- (a) its share of the jointly controlled assets, classified according to the nature of the assets;
 - (b) any liabilities that it has incurred;
 - (c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;
 - (d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and
 - (e) any expenses that it has incurred in respect of its interest in the joint venture.

JOINTLY CONTROLLED ENTITIES

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

Measurement—accounting policy election

- 15.9 A venturer which is not a parent but has one or more interests in jointly controlled entities shall account for all of its interests in jointly controlled entities using the cost model in paragraph 15.10.
- 15.9A An investor shall, in its consolidated financial statements, account for all of its investments in joint ventures using the equity method in paragraph 15.13.

Cost model

- 15.10 A venturer which is not a parent shall measure its investments in jointly controlled entities, at cost less any accumulated impairment losses recognised in accordance with Section 27 *Impairment of Assets*.
- 15.11 The investor shall recognise distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the jointly controlled entity arising before or after the date of acquisition.
- 15.12 [not used]

Equity method

- 15.13 A venturer shall measure its investments in jointly controlled entities by the equity method using the

procedures in paragraph 14.8 (substituting ‘joint control’ where that paragraph refers to ‘significant influence’).

Fair value model

15.14 [not used]

15.15 [not used]

TRANSACTIONS BETWEEN A VENTURER AND A JOINT VENTURE

- 15.16 When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of an impairment loss.
- 15.17 When a venturer purchases assets from a joint venture, the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent an **impairment loss**.

IF INVESTOR DOES NOT HAVE JOINT CONTROL

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

DISCLOSURES

- 15.19 An investor in a joint venture shall disclose:
- (a) the **accounting policy** it uses for recognising its interests in jointly controlled entities.
 - (b) the **carrying amount** of investments in jointly controlled entities (see paragraph 4.2(k)).
 - (c) the fair value of investments in jointly controlled entities accounted for using the equity method for which there are published price quotations.
 - (d) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves.
- 15.20 For jointly controlled entities accounted for in accordance with the equity method, the venturer shall also make the disclosures required by paragraph 14.14 for equity method investments.
- 15.21 [not used]

SECTION 16: INVESTMENT PROPERTY

SCOPE OF THIS SECTION

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

DEFINITION AND INITIAL RECOGNITION OF INVESTMENT PROPERTY

- 16.2 Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a **finance lease** to earn rentals or for capital appreciation or both, rather than for:
- (a) use in the production or supply of goods or services or for administrative purposes, or
 - (b) sale in the ordinary course of business.
- 16.3 A property interest that is held by a lessee under an **operating lease** may be classified and accounted for as investment property using this section if, and only if, the property would otherwise meet the definition of an investment property and the lessee can measure the fair value of the property interest without undue cost or effort

on an ongoing basis. This classification alternative is available on a property-by-property basis.

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

MEASUREMENT AT INITIAL RECOGNITION

- 16.5 An entity shall measure investment property at its cost at initial recognition. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other transaction costs. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments. An entity shall determine the cost of a self-constructed investment property in accordance with paragraphs 17.10–17.14.
- 16.6 The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 20.9, even if the lease would otherwise be classified as an operating lease if it was in the scope of Section 20 *Leases*. In other words, the asset is recognised at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount is recognised as a liability in accordance with paragraph 20.9.

MEASUREMENT AFTER RECOGNITION

- 16.7 Investment property whose fair value can be measured reliably without undue cost or effort shall be measured at fair value at each **reporting date** with changes in fair value recognised in profit or loss. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying

property. Paragraphs 11.27–11.32 provide guidance on determining fair value. An entity shall account for all other investment property as property, plant and equipment using the cost–depreciation–impairment model in Section 17.

TRANSFERS

- 16.8 If a reliable measure of fair value is no longer available without undue cost or effort for an item of investment property measured using the fair value model, the entity shall thereafter account for that item as property, plant and equipment in accordance with Section 17 until a reliable measure of fair value becomes available. The carrying amount of the investment property on that date becomes its cost under Section 17. Paragraph 16.10(e)(iii) requires disclosure of this change. It is a change of circumstances and not a change in accounting policy.
- 16.9 Other than as required by paragraph 16.8, an entity shall transfer a property to, or from, investment property only when the property first meets, or ceases to meet, the definition of investment property.

DISCLOSURES

- 16.10 An entity shall disclose the following for all investment property accounted for at fair value through profit or loss (paragraph 16.7):
- (a) the methods and significant assumptions applied in determining the fair value of investment property.
 - (b) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.

- (c) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
- (d) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.
- (e) a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:
 - (i) additions, disclosing separately those additions resulting from acquisitions through business combinations.
 - (ii) net gains or losses from fair value adjustments.
 - (iii) transfers to property, plant and equipment when a reliable measure of fair value is no longer available without undue cost or effort (see paragraph 16.8).
 - (iv) transfers to and from inventories and owner-occupied property.
 - (v) other changes.

This reconciliation need not be presented for prior periods.

- 16.11 In accordance with Section 20, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance lease or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

SECTION 17: PROPERTY, PLANT AND EQUIPMENT

SCOPE

- 17.1 This section applies to accounting for **property, plant and equipment** and **investment property** whose fair value cannot be measured reliably without undue cost or effort. Section 16 *Investment Property* applies to investment property whose fair value can be measured reliably without undue cost or effort.
- 17.2 Property, plant and equipment are tangible assets that:
- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and
 - (b) are expected to be used during more than one period.
- 17.3 Property, plant and equipment does not include:
- (a) biological assets related to agricultural activity (see Section 34 *Specialised Activities*), or
 - (b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

RECOGNITION

- 17.4 An entity shall apply the recognition criteria in paragraph 2.27 in determining whether to recognise an item of property, plant or equipment. Therefore, the entity shall recognise the cost of an item of property, plant and equipment as an asset if, and only if:
- (a) it is **probable** that future economic benefits associated with the item will flow to the entity, and

- (b) the cost of the item can be measured reliably.
- 17.5 Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed. However, major spare parts and stand-by equipment are property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are considered property, plant and equipment.
- 17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (eg the roof of a building). An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 17.27–17.30. Paragraph 17.16 provides that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and **depreciate** each such component separately over its **useful life**.
- 17.7 A condition of continuing to operate an item of property, plant and equipment (eg a bus) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as

an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

- 17.8 Land and buildings are separable assets, and an entity shall account for them separately, even when they are acquired together.

MEASUREMENT AT RECOGNITION

- 17.9 An entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

- 17.10 The cost of an item of property, plant and equipment comprises all of the following:
- (a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
 - (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality.
 - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

- 17.11 The following costs are not costs of an item of property, plant and equipment, and an entity shall recognise them as an expense when they are incurred:
- (a) costs of opening a new facility.
 - (b) costs of introducing a new product or service (including costs of advertising and promotional activities).
 - (c) costs of conducting business in a new location or with a new class of customer (including costs of staff training).
 - (d) administration and other general overhead costs.
 - (e) **borrowing costs** (see Section 25 *Borrowing Costs*).
- 17.12 The income and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in profit or loss if those operations are not necessary to bring the item to its intended location and operating condition.

Measurement of cost

- 17.13 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments.

Exchanges of assets

- 17.14 An item of property, plant or equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of the acquired asset at **fair value** unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case,

the asset's cost is measured at the carrying amount of the asset given up.

MEASUREMENT AFTER INITIAL RECOGNITION

- 17.15 An entity shall measure all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated **impairment losses**. An entity shall recognise the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

DEPRECIATION

- 17.16 If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.
- 17.17 The depreciation charge for each period shall be recognised in profit or loss unless another section of this FRS requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 13 *Inventories*).

DEPRECIABLE AMOUNT AND DEPRECIATION PERIOD

- 17.18 An entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.

- 17.19 Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement, and changes in market prices may indicate that the residual value or useful life of an asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The entity shall account for the change in residual value, depreciation method or useful life as a change in an **accounting estimate** in accordance with paragraphs 10.15–10.18.
- 17.20 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.
- 17.21 An entity shall consider all the following factors in determining the useful life of an asset:
- (a) the expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
 - (b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
 - (c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.

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

DEPRECIATION METHOD

- 17.22 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and a method based on usage such as the units of production method.
- 17.23 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset's future economic benefits, the entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with paragraphs 10.15–10.18.

IMPAIRMENT

Recognition and measurement of impairment

- 17.24 At each **reporting date**, an entity shall apply Section 27 *Impairment of Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

Compensation for impairment

- 17.25 An entity shall include in profit or loss compensation from third parties for items of property, plant and equipment that were impaired, lost or given up only when the compensation becomes receivable.

Property, plant and equipment held for sale

- 17.26 Paragraph 27.9(f) states that a plan to dispose of an asset before the previously expected date is an indicator of impairment that triggers the calculation of the asset's recoverable amount for the purpose of determining whether the asset is impaired.

DERECOGNITION

- 17.27 An entity shall derecognise an item of property, plant and equipment:
- (a) on disposal, or
 - (b) when no future economic benefits are expected from its use or disposal.
- 17.28 An entity shall recognise the gain or loss on the derecognition of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue.
- 17.29 In determining the date of disposal of an item, an entity shall apply the criteria in Section 23 *Revenue* for recognising revenue from the sale of goods. Section 20 applies to disposal by a sale and leaseback.
- 17.30 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

DISCLOSURES

- 17.31 An entity shall disclose the following for each class of property, plant and equipment that was deemed appropriate in accordance with paragraph 4.11(a):
- (a) the measurement bases used for determining the gross carrying amount.
 - (b) the depreciation methods used.
 - (c) the useful lives or the depreciation rates used.
 - (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period.
 - (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
 - (i) additions.
 - (ii) disposals.
 - (iii) acquisitions through **business combinations**.
 - (iv) transfers to investment property if a reliable measure of fair value becomes available (see paragraph 16.8).
 - (v) impairment losses recognised or reversed in profit or loss in accordance with Section 27.
 - (vi) depreciation.
 - (vii) other changes.

This reconciliation need not be presented for prior periods.

17.32 The entity shall also disclose the following:

- (a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for liabilities.
- (b) the amount of contractual commitments for the acquisition of property, plant and equipment.

SECTION 18: INTANGIBLE ASSETS OTHER THAN GOODWILL

SCOPE OF THIS SECTION

- 18.1 This section applies to accounting for all **intangible assets** other than goodwill (see Section 19 *Business Combinations and Goodwill*) and intangible assets held by an entity for sale in the ordinary course of business (see Section 13 *Inventories* and Section 23 *Revenue*).
- 18.2 An intangible asset is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:
- (a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability, or
 - (b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- 18.3 Intangible assets do not include:
- (a) **financial assets**, or
 - (b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

RECOGNITION

General principle for recognising intangible assets

- 18.4 An entity shall apply the recognition criteria in paragraph 2.27 in determining whether to recognise an intangible asset. Therefore, the entity shall recognise an intangible asset as an asset if, and only if:

- (a) it is **probable** that the expected future economic benefits that are attributable to the asset will flow to the entity;
 - (b) the cost or value of the asset can be measured reliably; and
 - (c) the asset does not result from expenditure incurred internally on an intangible item.
- 18.5 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the **useful life** of the asset.
- 18.6 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.
- 18.7 The probability recognition criterion in paragraph 18.4(a) is always considered satisfied for intangible assets that are separately acquired.

Acquisition as part of a business combination

- 18.8 An intangible asset acquired in a **business combination** is normally recognised as an asset because its **fair value** can be measured with sufficient reliability. However, an intangible asset acquired in a business combination is not recognised when it arises from legal or other contractual rights and its fair value cannot be measured reliably because the asset either
- (a) is not separable from **goodwill**, or
 - (b) is separable from goodwill but there is no history or evidence of exchange transactions for the same or

similar assets, and otherwise estimating fair value would be dependent on immeasurable variables.

INITIAL MEASUREMENT

18.9 An entity shall measure an intangible asset initially at cost.

Separate acquisition

18.10 The cost of a separately acquired intangible asset comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, and
- (b) any directly attributable cost of preparing the asset for its intended use.

Acquisition as part of a business combination

18.11 If an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date.

Acquisition by way of a government grant

18.12 If an intangible asset is acquired by way of a **government grant**, the cost of that intangible asset is its fair value at the date the grant is received or receivable in accordance with Section 24 *Government Grants*.

Exchanges of assets

18.13 An intangible asset may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of such an intangible asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up

is reliably measurable. In that case, the asset's cost is measured at the **carrying amount** of the asset given up.

Internally generated intangible assets

- 18.14 An entity shall recognise expenditure incurred internally on an intangible item, including all expenditure for both **research** and **development** activities, as an expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in this FRS.
- 18.15 As examples of applying the preceding paragraph, an entity shall recognise expenditure on the following items as an expense and shall not recognise such expenditure as intangible assets:
- (a) internally generated brands, logos, publishing titles, customer lists and items similar in substance.
 - (b) start-up activities (ie start-up costs), which include establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) and expenditure for starting new operations or launching new products or processes (ie pre-operating costs).
 - (c) training activities.
 - (d) advertising and promotional activities.
 - (e) relocating or reorganising part or all of an entity.
 - (f) internally generated goodwill.
- 18.16 Paragraph 18.15 does not preclude recognising a prepayment as an asset when payment for goods or services has been made in advance of the delivery of the goods or the rendering of the services.

PAST EXPENSES NOT TO BE RECOGNISED AS AN ASSET

- 18.17 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised at a later date as part of the cost of an asset.

MEASUREMENT AFTER RECOGNITION

- 18.18 An entity shall measure intangible assets at cost less any accumulated **amortisation** and any accumulated **impairment losses**. The requirements for amortisation are set out in this section. The requirements for recognition of impairment are set out in Section 27 *Impairment of Assets*.

AMORTISATION OVER USEFUL LIFE

- 18.19 For the purpose of this FRS, all intangible assets shall be considered to have a finite useful life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.
- 18.20 If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years.

Amortisation period and amortisation method

- 18.21 An entity shall allocate the **depreciable amount** of an intangible asset on a systematic basis over its useful life. The amortisation charge for each period shall be recognised as an expense, unless another section of this FRS requires the

cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

- 18.22 Amortisation begins when the intangible asset is available for use, ie when it is in the location and condition necessary for it to be usable in the manner intended by management. Amortisation ceases when the asset is derecognised. The entity shall choose an amortisation method that reflects the pattern in which it expects to consume the asset's future economic benefits. If the entity cannot determine that pattern reliably, it shall use the straight-line method.

Residual value

- 18.23 An entity shall assume that the **residual value** of an intangible asset is zero unless:
- (a) there is a commitment by a third party to purchase the asset at the end of its useful life, or
 - (b) there is an active market for the asset and:
 - (i) residual value can be determined by reference to that market, and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.

Review of amortisation period and amortisation method

- 18.24 Factors such as a change in how an intangible asset is used, technological advancement, and changes in market prices may indicate that the residual value or useful life of an intangible asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, amortisation method or useful life. The entity shall account for the change in residual value, amortisation method or useful life

as a change in an **accounting estimate** in accordance with paragraphs 10.15–10.18.

RECOVERABILITY OF THE CARRYING AMOUNT—IMPAIRMENT LOSSES

- 18.25 To determine whether an intangible asset is impaired, an entity shall apply Section 27. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

RETIREMENTS AND DISPOSALS

- 18.26 An entity shall derecognise an intangible asset, and shall recognise a gain or loss in profit or loss:
- (a) on disposal, or
 - (b) when no future economic benefits are expected from its use or disposal.

DISCLOSURES

- 18.27 An entity shall disclose the following for each class of intangible assets:
- (a) the useful lives or the amortisation rates used.
 - (b) the amortisation methods used.
 - (c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period.
 - (d) the line item(s) in the **statement of comprehensive income** (and in the **income statement**, if presented) in which any amortisation of intangible assets is included.

- (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
 - (i) additions.
 - (ii) disposals.
 - (iii) acquisitions through business combinations.
 - (iv) amortisation.
 - (v) impairment losses.
 - (vi) other changes.

This reconciliation need not be presented for prior periods.

18.28 An entity shall also disclose:

- (a) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is **material** to the entity's **financial statements**.
- (b) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 18.12):
 - (i) the fair value initially recognised for these assets, and
 - (ii) their carrying amounts.
- (c) the existence and carrying amounts of intangible assets to which the entity has restricted title or that are pledged as security for liabilities.
- (d) the amount of contractual commitments for the acquisition of intangible assets.

- 18.29 An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period (ie the amount of expenditure incurred internally on research and development that has not been capitalised as part of the cost of another asset that meets the recognition criteria in this FRS).

SECTION 19: BUSINESS COMBINATIONS AND GOODWILL

SCOPE OF THIS SECTION

- 19.1 This section applies to accounting for **business combinations**. It provides guidance on identifying the acquirer, measuring the cost of the business combination, and allocating that cost to the assets acquired and liabilities and provisions for **contingent liabilities** assumed. It also addresses accounting for **goodwill** both at the time of a business combination and subsequently.
- 19.2 This section specifies the accounting for all business combinations except:
- (a) combinations of entities or **businesses** under common **control**. Common control means that all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination, and that control is not transitory.
 - (b) the formation of a **joint venture**.
 - (c) acquisition of a group of assets that do not constitute a business.

BUSINESS COMBINATIONS DEFINED

- 19.3 A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree.
- 19.4 A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the

purchase by an entity of the equity of another entity, the purchase of all the net assets of another entity, the assumption of the liabilities of another entity, or the purchase of some of the net assets of another entity that together form one or more businesses.

- 19.5 A business combination may be effected by the issue of equity instruments, the transfer of cash, **cash equivalents** or other assets, or a mixture of these. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.

ACCOUNTING

- 19.6 All business combinations shall be accounted for by applying the purchase method.
- 19.7 Applying the purchase method involves the following steps:
- (a) identifying an acquirer.
 - (b) measuring the cost of the business combination.
 - (c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and provisions for **contingent liabilities** assumed.

Identifying the acquirer

- 19.8 An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.
- 19.9 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from

its activities. Control of one entity by another is described in Section 9 *Consolidated and Separate Financial Statements*.

- 19.10 Although it may sometimes be difficult to identify an acquirer, there are usually indications that one exists. For example:
- (a) if the **fair value** of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer.
 - (b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer.
 - (c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

Cost of a business combination

- 19.11 The acquirer shall measure the cost of a business combination as the aggregate of:
- (a) the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree, plus
 - (b) any costs directly attributable to the business combination.

Adjustments to the cost of a business combination contingent on future events

- 19.12 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the estimated amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is **probable** and can be measured reliably.
- 19.13 However, if the potential adjustment is not recognised at the acquisition date but subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed

- 19.14 The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets and liabilities and a provision for those contingent liabilities that satisfy the recognition criteria in paragraph 19.20 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities so recognised shall be accounted for in accordance with paragraphs 19.22–19.24 (as goodwill or so-called 'negative goodwill').
- 19.15 The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:
- (a) In the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably.

- (b) In the case of a liability other than a contingent liability, it is probable that an outflow of resources will be required to settle the obligation, and its fair value can be measured reliably.
 - (c) In the case of an intangible asset or a contingent liability, its fair value can be measured reliably.
- 19.16 The acquirer's statement of comprehensive income shall incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's statement of comprehensive income that relates to the acquiree's depreciable assets shall be based on the fair values of those depreciable assets at the acquisition date, ie their cost to the acquirer.
- 19.17 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.
- 19.18 In accordance with paragraph 19.14, the acquirer recognises separately only the identifiable assets, liabilities and contingent liabilities of the acquiree that existed at the acquisition date and satisfy the recognition criteria in paragraph 19.15. Therefore:
 - (a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability

for restructuring recognised in accordance with Section 21 *Provisions and Contingencies*; and

- (b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.
- 19.19 If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall recognise in its financial statements provisional amounts for the items for which the accounting is incomplete. Within twelve months after the acquisition date, the acquirer shall retrospectively adjust the provisional amounts recognised as assets and liabilities at the acquisition date (ie account for them as if they were made at the acquisition date) to reflect new information obtained. Beyond twelve months after the acquisition date, adjustments to the initial accounting for a business combination shall be recognised only to correct an error in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Contingent liabilities

- 19.20 Paragraph 19.14 specifies that the acquirer recognises separately a provision for a contingent liability of the acquiree only if its fair value can be measured reliably. If its fair value cannot be measured reliably:
- (a) there is a resulting effect on the amount recognised as goodwill or accounted for in accordance with paragraph 19.24; and
 - (b) the acquirer shall disclose the information about that contingent liability as required by Section 21.
- 19.21 After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 19.14 at the higher of:

- (a) the amount that would be recognised in accordance with Section 21, and
- (b) the amount initially recognised less amounts previously recognised as revenue in accordance with Section 23 *Revenue*.

Goodwill

19.22 The acquirer shall, at the acquisition date:

- (a) recognise goodwill acquired in a business combination as an asset, and
- (b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 19.14.

19.23 After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less accumulated **amortisation** and accumulated **impairment** losses:

- (a) An entity shall follow the principles in paragraphs 18.19–18.24 for amortisation of goodwill. The life of goodwill shall be presumed to be five years or less unless the goodwill has a longer useful economic life.
- (b) An entity shall follow Section 27 *Impairment of Assets* for recognising and measuring the impairment of goodwill.

Excess over cost of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities

19.24 If the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent

liabilities recognised in accordance with paragraph 19.14 exceeds the cost of the business combination (sometimes referred to as ‘negative goodwill’), the acquirer shall:

- (a) reassess the identification and measurement of the acquiree’s assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination, and
- (b) recognise any excess which remains after the reassessment in profit or loss in the periods in which the non-monetary assets acquired are recovered.

DISCLOSURES

For business combination(s) effected during the reporting period

- 19.25 For each business combination that was effected during the period, the acquirer shall disclose the following:
- (a) the names and descriptions of the combining entities or businesses.
 - (b) the acquisition date.
 - (c) the percentage of voting equity instruments acquired.
 - (d) the cost of the combination and a description of the components of that cost (such as cash, equity instruments and debt instruments).
 - (e) the amounts recognised at the acquisition date for each class of the acquiree’s assets, liabilities and contingent liabilities, including goodwill.
 - (f) the amount of any excess recognised in profit or loss in accordance with paragraph 19.24, and the line item in

the statement of comprehensive income (and in the income statement, if presented) in which the excess is recognised.

- (g) the useful life of goodwill, if this exceeds five years, and supporting reasons for this.

For all business combinations

19.26 An acquirer shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing separately:

- (a) changes arising from new business combinations.
- (b) impairment losses.
- (c) disposals of previously acquired businesses.
- (d) other changes.

This reconciliation need not be presented for prior periods.

SECTION 20: LEASES

SCOPE OF THIS SECTION

- 20.1 This section covers accounting for all **leases** other than:
- (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see Section 34 *Specialised Activities*).
 - (b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 18 *Intangible Assets other than Goodwill*).
 - (c) measurement of property held by lessees that is accounted for as **investment property** and measurement of investment property provided by lessors under operating leases (see Section 16 *Investment Property*).
 - (d) measurement of **biological assets** held by lessees under finance leases and biological assets provided by lessors under operating leases (see Section 34).
 - (e) leases that could lead to a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased asset, changes in foreign exchange rates, or a default by one of the counterparties (see paragraph 12.3(f)).
 - (f) operating leases that are onerous.
- 20.2 This section applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not

transfer the right to use assets from one contracting party to the other.

- 20.3 Some arrangements, such as outsourcing arrangements, telecommunication contracts that provide rights to capacity, and take-or-pay contracts, do not take the legal form of a lease but convey rights to use assets in return for payments. Such arrangements are in substance leases of assets, and they should be accounted for under this section.

CLASSIFICATION OF LEASES

- 20.4 A lease is classified as a **finance lease** if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an **operating lease** if it does not transfer substantially all the risks and rewards incidental to ownership.
- 20.5 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term.
 - (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the **fair value** at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.
 - (c) the lease term is for the major part of the economic life of the asset even if title is not transferred.
 - (d) at the inception of the lease the **present value** of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

- (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.
- 20.6 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.
 - (b) gains or losses from the fluctuation in the **residual value** of the leased asset accrue to the lessee (eg in the form of a rent rebate equalling most of the sales proceeds at the end of the lease).
 - (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
- 20.7 The examples and indicators in paragraphs 20.5 and 20.6 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset is transferred to the lessee at the end of the lease for a variable payment equal to the asset's then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all risks and rewards incidental to ownership.
- 20.8 Lease classification is made at the inception of the lease and is not changed during the term of the lease unless the lessee and the lessor agree to change the provisions of the lease (other than simply by renewing the lease), in which case the lease classification shall be re-evaluated.

FINANCIAL STATEMENTS OF LESSEES—FINANCE LEASES

Initial recognition

- 20.9 At the commencement of the lease term, a lessee shall recognise its rights of use and obligations under finance leases as assets and liabilities in its statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease. Any initial direct costs of the lessee (incremental costs that are directly attributable to negotiating and arranging a lease) are added to the amount recognised as an asset.
- 20.10 The present value of the minimum lease payments should be calculated using the **interest rate implicit in the lease**. If this cannot be determined, the **lessee's incremental borrowing rate** shall be used.

Subsequent measurement

- 20.11 A lessee shall apportion minimum lease payments between the finance charge and the reduction of the outstanding liability using the **effective interest method** (see paragraphs 11.15–11.20). The lessee shall allocate the finance charge to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. A lessee shall charge contingent rents as expenses in the periods in which they are incurred.
- 20.12 A lessee shall depreciate an asset leased under a finance lease in accordance with the relevant section of this FRS for that type of asset, eg Section 17 *Property, Plant and Equipment*, Section 18 or Section 19 *Business Combinations and Goodwill*. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life. A lessee shall also assess at each **reporting**

date whether an asset leased under a finance lease is impaired (see Section 27 *Impairment of Assets*).

Disclosures

- 20.13 A lessee shall make the following disclosures for finance leases:
- (a) for each **class of asset**, the net **carrying amount** at the end of the **reporting period**.
 - (b) the total of future minimum lease payments at the end of the reporting period, for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.
- 20.14 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessees for assets leased under finance leases.

FINANCIAL STATEMENTS OF LESSEES—OPERATING LEASES

Recognition and measurement

- 20.15 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and

maintenance) as an expense on a straight-line basis unless either

- (a) another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis, or
- (b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then this condition (b) is not met.

Example of applying paragraph 20.15(b):

X operates in a jurisdiction in which the consensus forecast by local banks is that the general price level index, as published by the government, will increase by an average of 10 per cent annually over the next five years. X leases some office space from Y for five years under an operating lease. The lease payments are structured to reflect the expected 10 per cent annual general inflation over the five-year term of the lease as follows

Year 1	CU100,000
Year 2	CU110,000
Year 3	CU121,000
Year 4	CU133,000
Year 5	CU146,000

X recognises annual rent expense equal to the amounts owed to the lessor as shown above. If the escalating payments are not clearly structured to compensate the lessor for expected inflationary cost increases based on published indexes or statistics, then X recognises annual rent expense on a straight-line basis: CU122,000 each year (sum of the amounts payable under the lease divided by five years).

Disclosures

- 20.16 A lessee shall make the following disclosures for operating leases:
- (a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (b) lease payments recognised as an expense.
 - (c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

**FINANCIAL STATEMENTS OF LESSORS:
FINANCE LEASES**

Initial recognition and measurement

- 20.17 A lessor shall recognise assets held under a finance lease in their statements of financial position and present them as a receivable at an amount equal to the **net investment in the lease**. The net investment in a lease is the lessor's **gross investment in the lease** discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:
- (a) the minimum lease payments receivable by the lessor under a finance lease, and

(b) any unguaranteed residual value accruing to the lessor.

- 20.18 For finance leases other than those involving manufacturer or dealer lessors, initial direct costs (costs that are incremental and directly attributable to negotiating and arranging a lease) are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term.

Subsequent measurement

- 20.19 The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in profit or loss.

Manufacturer or dealer lessors

- 20.20 Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:
- (a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts, and
 - (b) finance income over the lease term.
- 20.21 The sales revenue recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value

of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity's policy for outright sales.

- 20.22 If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

Disclosures

- 20.23 A lessor shall make the following disclosures for finance leases:
- (a) a reconciliation between the gross investment in the lease at the end of the reporting period, and the present value of minimum lease payments receivable at the end of the reporting period. In addition, a lessor shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the end of the reporting period, for each of the following periods:
 - (i) not later than one year;
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (b) unearned finance income.

- (c) the unguaranteed residual values accruing to the benefit of the lessor.
- (d) the accumulated allowance for uncollectible minimum lease payments receivable.
- (e) contingent rents recognised as income in the period.
- (f) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

FINANCIAL STATEMENTS OF LESSORS: OPERATING LEASES

Recognition and measurement

- 20.24 A lessor shall present assets subject to operating leases in its statement of financial position according to the nature of the asset.
- 20.25 A lessor shall recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term, unless either
- (a) another systematic basis is representative of the time pattern of the lessee's benefit from the leased asset, even if the receipt of payments is not on that basis, or
 - (b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then condition (b) is not met.

- 20.26 A lessor shall recognise as an expense costs, including depreciation, incurred in earning the lease income. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.
- 20.27 A lessor shall add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.
- 20.28 To determine whether a leased asset has become impaired, a lessor shall apply Section 27.
- 20.29 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

Disclosures

- 20.30 A lessor shall disclose the following for operating leases:
- (a) the future minimum lease payments under non-cancellable operating leases for each of the following periods:
 - (i) not later than one year; and
 - (ii) later than one year and not later than five years; and
 - (iii) later than five years.
 - (b) total contingent rents recognised as income.
 - (c) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options

and escalation clauses, and restrictions imposed by lease arrangements.

- 20.31 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessors for assets provided under operating leases.

SALE AND LEASEBACK TRANSACTIONS

- 20.32 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease.

Sale and leaseback transaction results in a finance lease

- 20.33 If a sale and leaseback transaction results in a finance lease, the seller-lessee shall not recognise immediately, as income, any excess of sales proceeds over the carrying amount. Instead, the seller-lessee shall defer such excess and amortise it over the lease term.

Sale and leaseback transaction results in an operating lease

- 20.34 If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, the seller-lessee shall recognise any profit or loss immediately. If the sale price is below fair value, the seller-lessee shall recognise any profit or loss immediately unless the loss is compensated for by future lease payments at below market price. In that case the seller-lessee shall defer and amortise such loss in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the seller-lessee shall defer the excess over fair value and amortise it over the period for which the asset is expected to be used.

Disclosures

- 20.35 Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of significant leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

SECTION 21: PROVISIONS AND CONTINGENCIES

SCOPE OF THIS SECTION

- 21.1 This section applies to all **provisions** (ie liabilities of uncertain timing or amount), **contingent liabilities** and **contingent assets** except those provisions covered by other sections of this FRS. These include provisions relating to:
- (a) leases (Section 20 *Leases*). However, this section deals with operating leases that have become onerous.
 - (b) construction contracts (Section 23 *Revenue*).
 - (c) employee benefit obligations (Section 28 *Employee Benefits*).
 - (d) income tax (Section 29 *Income Tax*).
- 21.2 The requirements in this section do not apply to executory contracts unless they are **onerous contracts**. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.
- 21.3 The word ‘provision’ is sometimes used in the context of such items as depreciation, impairment of assets, and uncollectible receivables. Those are adjustments of the **carrying amounts** of assets, rather than recognition of liabilities, and therefore are not covered by this section.

INITIAL RECOGNITION

- 21.4 An entity shall recognise a provision only when:
- (a) the entity has an obligation at the **reporting date** as a result of a past event;

- (b) it is **probable** (ie more likely than not) that the entity will be required to transfer economic benefits in settlement; and
 - (c) the amount of the obligation can be estimated reliably.
- 21.5 The entity shall recognise the provision as a liability in the statement of financial position and shall recognise the amount of the provision as an expense, unless another section of this FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.
- 21.6 The condition in paragraph 21.4(a) (obligation at the reporting date as a result of a past event) means that the entity has no realistic alternative to settling the obligation. This can happen when the entity has a legal obligation that can be enforced by law or when the entity has a **constructive obligation** because the past event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. Obligations that will arise from the entity's future actions (ie the future conduct of its business) do not satisfy the condition in paragraph 21.4(a), no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a particular type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation or selling the factory, it has no present obligation for that future expenditure and no provision is recognised.

INITIAL MEASUREMENT

- 21.7 An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would

rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.

- (a) When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.
- (b) When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the entity considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

When the effect of the time value of money is **material**, the amount of a provision shall be the **present value** of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability should be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

- 21.8 An entity shall exclude gains from the expected disposal of assets from the measurement of a provision.
- 21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (eg through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The amount recognised for the

reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision.

SUBSEQUENT MEASUREMENT

- 21.10 An entity shall charge against a provision only those expenditures for which the provision was originally recognised.
- 21.11 An entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in profit or loss unless the provision was originally recognised as part of the cost of an asset (see paragraph 21.5). When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognised as a finance cost in profit or loss in the period it arises.

CONTINGENT LIABILITIES

- 21.12 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4. An entity shall not recognise a contingent liability as a liability, except for provisions for contingent liabilities of an acquiree in a business combination (see paragraphs 19.20 and 19.21). Disclosure of a contingent liability is required by paragraph 21.15 unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

CONTINGENT ASSETS

- 21.13 An entity shall not recognise a **contingent asset** as an asset. Disclosure of a contingent asset is required by paragraph 21.16 when an inflow of economic benefits is probable. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

DISCLOSURES

Disclosures about provisions

- 21.14 For each class of provision, an entity shall disclose all of the following:
- (a) a reconciliation showing
 - (i) the carrying amount at the beginning and end of the period;
 - (ii) additions during the period, including adjustments that result from changes in measuring the discounted amount;
 - (iii) amounts charged against the provision during the period; and
 - (iv) unused amounts reversed during the period.
 - (b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments.
 - (c) an indication of the uncertainties about the amount or timing of those outflows.
 - (d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Comparative information for prior periods is not required.

Disclosures about contingent liabilities

- 21.15 Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, when practicable:
- (a) an estimate of its financial effect, measured in accordance with paragraphs 21.7–21.11;
 - (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
 - (c) the possibility of any reimbursement.

If it is **impracticable** to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

- 21.16 If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the contingent assets at the end of the **reporting period**, and, when practicable without undue cost or effort, an estimate of their financial effect, measured using the principles set out in paragraphs 21.7–21.11. If it is impracticable to make this disclosure, that fact shall be stated.

Prejudicial disclosures

- 21.17 In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14–21.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall

disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

APPENDIX TO SECTION 21 GUIDANCE ON RECOGNISING AND MEASURING PROVISIONS

This Appendix accompanies, but is not part of, Section 21. It provides guidance for applying the requirements of Section 21 in recognising and measuring provisions.

All of the entities in the examples in this Appendix have 31 December as their reporting date. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets; this aspect is not dealt with in the examples. References to ‘best estimate’ are to the present value amount, when the effect of the time value of money is material.

Example 1 Future operating losses

- 21A.1 An entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event—There is no past event that obliges the entity to pay out resources.

Conclusion—The entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired—see Section 27 *Impairment of Assets*.

Example 2 Onerous contracts

- 21A.2 An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost

of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, an entity may be contractually required under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event—The entity is contractually required to pay out resources for which it will not receive commensurate benefits.

Conclusion—If an entity has a contract that is onerous, the entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

21A.3 A restructuring is a programme that is planned and controlled by management and materially changes either the scope of a business undertaken by an entity or the manner in which that business is conducted.

Present obligation as a result of a past obligating event—A constructive obligation to restructure arises only when an entity:

- (a) has a detailed formal plan for the restructuring identifying at least:
 - (i) the business or part of a business concerned;
 - (ii) the principal locations affected;
 - (iii) the location, function and approximate number of employees who will be compensated for terminating their services;
 - (iv) the expenditures that will be undertaken; and

- (v) when the plan will be implemented; and
- (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Conclusion—An entity recognises a provision for restructuring costs only when it has a legal or constructive obligation at the reporting date to carry out the restructuring.

Example 4 Warranties

- 21A.4 A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On the basis of experience, it is probable (ie more likely than not) that there will be some claims under the warranties.

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

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

Conclusion—The entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

Illustration of calculations:

In 20X0, goods are sold for CU1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement

costing 70 per cent of sale price. Therefore estimated warranty costs are:

CU1,000,000 × 90% × 0 =	CU0
CU1,000,000 × 6% × 30% =	CU18,000
CU1,000,000 × 4% × 70% =	CU28,000
Total	CU46,000

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2, and 10 per cent in 20X3, in each case at the end of the period. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the entity uses a ‘risk-free’ discount rate based on government bonds with the same term as the expected cash outflows (6 per cent for one-year bonds and 7 per cent for two-year and three-year bonds). Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		Expected cash payments (CU)	Discount rate	Discount factor	Present value (CU)
1	60% × CU46,000	27,600	6%	0.9434 (at 6% for 1 year)	26,038
2	30% × CU46,000	13,800	7%	0.8734 (at 7% for 2 years)	12,053
3	10% × CU46,000	4,600	7%	0.8163 (at 7% for 3 years)	3,755
Total					41,846

The entity will recognise a warranty obligation of CU41,846 at the end of 20X0 for products sold in 20X0.

Example 5 Refunds policy

- 21A.5 A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event—The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement—Probable that a proportion of goods will be returned for refund.

Conclusion—The entity recognises a provision for the best estimate of the amount required to settle the refunds.

Example 6 Closure of a division—no implementation before end of reporting period

21A.6 On 12 December 20X0 the board of an entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event—There has been no obligating event, and so there is no obligation.

Conclusion—The entity does not recognise a provision.

Example 7 Closure of a division—communication and implementation before end of reporting period

21A.7 On 12 December 20X0 the board of an entity decided to close a division making a particular product. On 20 December 20X0 a detailed plan for closing the division was agreed by the board, letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event—The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

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

Conclusion—The entity recognises a provision at 31 December 20X0 for the best estimate of the costs that

would be incurred to close the division at the reporting date.

Example 8 Staff retraining as a result of changes in the income tax system

- 21A.8 The government introduces changes to the income tax system. As a result of those changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with tax regulations. At the end of the reporting period, no retraining of staff has taken place.

Present obligation as a result of a past obligating event—The tax law change does not impose an obligation on an entity to do any retraining. An obligating event for recognising a provision (the retraining itself) has not taken place.

Conclusion—The entity does not recognise a provision.

Example 9 A court case

- 21A.9 A customer has sued Entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Entity X. Entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the entity will be found liable.

- (a) At 31 December 20X1

Present obligation as a result of a past obligating event—On the basis of the evidence available when

the financial statements were approved, there is no obligation as a result of past events.

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

(b) At 31 December 20X2

Present obligation as a result of a past obligating event—On the basis of the evidence available, there is a present obligation. The obligating event is the sale of the product to the customer.

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

Conclusion—A provision is recognised at the best estimate of the amount to settle the obligation at 31 December 20X2, and the expense is recognised in profit or loss. It is not a correction of an error in 20X1 because, on the basis of the evidence available when the 20X1 financial statements were approved, a provision should not have been recognised at that time.

SECTION 22 : LIABILITIES AND EQUITY

SCOPE OF THIS SECTION

- 22.1 This section establishes principles for classifying financial instruments as either liabilities or equity and addresses accounting for equity instruments issued to individuals or other parties acting in their capacity as investors in **equity** instruments (ie in their capacity as **owners**). Section 26 *Share-based Payment* addresses accounting for a transaction in which the entity receives goods or services (including employee services) as consideration for its equity instruments (including shares or share options) from employees and other vendors acting in their capacity as vendors of goods and services.
- 22.2 This section shall be applied when classifying all types of financial instruments except:
- (a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Interests in Joint Ventures*.
 - (b) employers' rights and obligations under employee benefit plans, to which Section 28 *Employee Benefits* applies.
 - (c) contracts for contingent consideration in a business combination (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.
 - (d) financial instruments, contracts and obligations under share-based payment transactions to which Section 26 applies, except that paragraphs 22.3–22.6 shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option

plans, employee share purchase plans, and all other share-based payment arrangements.

CLASSIFICATION OF AN INSTRUMENT AS LIABILITY OR EQUITY

- 22.3 Equity is the residual interest in the assets of an entity after deducting all its liabilities. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Equity includes investments by the **owners** of the entity, plus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners.
- 22.4 Some financial instruments that meet the definition of a **liability** are classified as equity because they represent the residual interest in the net assets of the entity:
- (a) A puttable instrument is a financial instrument that gives the holder the right to sell that instrument back to the issuer for cash or another financial asset or is automatically redeemed or repurchased by the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. A puttable instrument that has all of the following features is classified as an equity instrument:
 - (i) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets.
 - (ii) The instrument is in the class of instruments that is subordinate to all other classes of instruments.

- (iii) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features.
 - (iv) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments.
 - (v) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).
- (b) Instruments, or components of instruments, that are subordinate to all other classes of instruments are classified as equity if they impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

22.5 The following are examples of instruments that are classified as liabilities rather than equity:

- (a) An instrument is classified as a liability if the distribution of net assets on liquidation is subject to a maximum amount (a ceiling). For example, if in liquidation the holders of the instrument receive a pro rata share of the net assets, but this amount is limited to a ceiling and the excess net assets are distributed to a

charity organisation or the government, the instrument is not classified as equity.

- (b) A puttable instrument is classified as equity if, when the put option is exercised, the holder receives a pro rata share of the net assets of the entity measured in accordance with this FRS. However, if the holder is entitled to an amount measured on some other basis (such as local GAAP), the instrument is classified as a liability.
 - (c) An instrument is classified as a liability if it obliges the entity to make payments to the holder before liquidation, such as a mandatory dividend.
 - (d) A puttable instrument that is classified as equity in a subsidiary's financial statements is classified as a liability in the consolidated **group** financial statements.
 - (e) A preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.
- 22.6 Members' shares in co-operative entities and similar instruments are equity if:
- (a) the entity has an unconditional right to refuse redemption of the members' shares, or
 - (b) redemption is unconditionally prohibited by local law, regulation or the entity's governing charter.

ORIGINAL ISSUE OF SHARES OR OTHER EQUITY INSTRUMENTS

- 22.7 An entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and

another party is obliged to provide cash or other resources to the entity in exchange for the instruments.

- (a) [not used]
- (b) If the entity receives the cash or other resources before the equity instruments are issued, and the entity cannot be required to repay the cash or other resources received, the entity shall recognise the corresponding increase in equity to the extent of consideration received.
- (c) To the extent that the equity instruments have been subscribed for but not issued, and the entity has not yet received the cash or other resources, the entity shall not recognise an increase in equity.

22.8 An entity shall measure the equity instruments at the fair value of the cash or other resources received or receivable, net of direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement shall be on a **present value** basis.

22.9 An entity shall account for the transaction costs of an equity transaction as a deduction from equity, net of any related income tax benefit.

22.10 How the increase in equity arising on the issue of shares or other equity instruments is presented in the statement of financial position is determined by applicable laws. For example, the par value (or other nominal value) of shares and the amount paid in excess of par value may be presented separately.

SALE OF OPTIONS, RIGHTS AND WARRANTS

22.11 An entity shall apply the principles in paragraphs 22.7–22.10 to equity issued by means of sales of options, rights, warrants and similar equity instruments.

CAPITALISATION OR BONUS ISSUES OF SHARES AND SHARE SPLITS

- 22.12 A capitalisation or bonus issue (sometimes referred to as a stock dividend) is the issue of new shares to shareholders in proportion to their existing holdings. For example, an entity may give its shareholders one dividend or bonus share for every five shares held. A share split (sometimes referred to as a stock split) is the dividing of an entity's existing shares into multiple shares. For example, in a share split, each shareholder may receive one additional share for each share held. In some cases, the previously outstanding shares are cancelled and replaced by new shares. Capitalisation and bonus issues and share splits do not change total equity. An entity shall reclassify amounts within equity as required by applicable laws.

CONVERTIBLE DEBT OR SIMILAR COMPOUND FINANCIAL INSTRUMENTS

- 22.13 On issuing convertible debt or similar compound **financial instruments** that contain both a liability and an equity component, an entity shall allocate the proceeds between the liability component and the equity component. To make the allocation, the entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have a conversion feature or similar associated equity component. The entity shall allocate the residual amount as the equity component. Transaction costs shall be allocated between the debt component and the equity component on the basis of their relative fair values.
- 22.14 The entity shall not revise the allocation in a subsequent period.
- 22.15 In periods after the instruments were issued, the entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest expense using the **effective interest**

method (see paragraphs 11.15–11.20). The appendix to this section illustrates the issuer’s accounting for convertible debt.

TREASURY SHARES

- 22.16 Treasury shares are the equity instruments of an entity that have been issued and subsequently reacquired by the entity. An entity shall deduct from equity the fair value of the consideration given for the treasury shares. The entity shall not recognise a gain or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares.

DISTRIBUTIONS TO OWNERS

- 22.17 An entity shall reduce equity for the amount of distributions to its owners (holders of its equity instruments), net of any related income tax benefits. Paragraph 29.65A provides guidance on accounting for a withholding tax on dividends.
- 22.18 Sometimes an entity distributes assets other than cash as dividends to its owners. When an entity declares such a distribution and has an obligation to distribute non-cash assets to its owners, it shall recognise a liability. It shall measure the liability at the fair value of the assets to be distributed. At the end of each **reporting period** and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable to reflect changes in the fair value of the assets to be distributed, with any changes recognised in equity as adjustments to the amount of the distribution.

NON-CONTROLLING INTEREST AND TRANSACTIONS IN SHARES OF A CONSOLIDATED SUBSIDIARY

- 22.19 In **consolidated financial statements**, a non-controlling interest in the net assets of a subsidiary is included in equity. An entity shall treat changes in a parent’s controlling

interest in a subsidiary that do not result in a loss of **control** as transactions with equity holders in their capacity as equity holders. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to equity holders of the parent. An entity shall not recognise gain or loss on these changes. Also, an entity shall not recognise any change in the **carrying amounts** of assets (including goodwill) or liabilities as a result of such transactions.

APPENDIX TO SECTION 22 EXAMPLE OF THE ISSUER'S ACCOUNTING FOR CONVERTIBLE DEBT

The Appendix accompanies, but is not part of, Section 22. It provides guidance for applying the requirements of paragraphs 22.13–22.15.

On 1 January 20X5 an entity issues 500 convertible bonds. The bonds are issued at par with a face value of CU100 per bond and are for a five-year term, with no transaction costs. The total proceeds from the issue are CU50,000. Interest is payable annually in arrears at an annual interest rate of 4 per cent. Each bond is convertible, at the holder's discretion, into 25 ordinary shares at any time up to maturity. At the time the bonds are issued, the market interest rate for similar debt that does not have the conversion option is 6 per cent.

When the instrument is issued, the liability component must be valued first, and the difference between the total proceeds on issue (which is the fair value of the instrument in its entirety) and the fair value of the liability component is assigned to the equity component. The fair value of the liability component is calculated by determining its present value using the discount rate of 6 per cent. The calculations and journal entries are illustrated below:

	CU
Proceeds from the bond issue (A)	50,000
Present value of principal at the end of five years (see calculations below)	37,363
Present value of interest payable annually in arrears for five years	8,425
Present value of liability, which is the fair value of liability component (B)	45,788
Residual, which is the fair value of the equity component (A) – (B)	4,212

The issuer of the bonds makes the following journal entry at issue on 1 January 20X5:

Dr Cash	CU50,000
Cr Financial Liability – Convertible bond	CU45,788
Cr Equity	CU4,212

The CU4,212 represents a discount on issue of the bonds, so the entry could also be shown ‘gross’:

Dr Cash	CU50,000
Dr Bond discount	CU4,212
Cr Financial Liability – Convertible bond	CU50,000
Cr Equity	CU4,212

After issue, the issuer will amortise the bond discount according to the following table:

	(a) Interest payment (CU)	(b) Total interest expense (CU) = 6% x (e)	(c) Amortisation of bond discount (CU) = (b) – (a)	(d) Bond discount (CU) = (d) – (c)	(e) Net liability (CU) = 50,000 – (d)
1/1/20X5				4,212	45,788
31/12/20X5	2,000	2,747	747	3,465	46,535
31/12/20X6	2,000	2,792	792	2,673	47,327
31/12/20X7	2,000	2,840	840	1,833	48,167
31/12/20X8	2,000	2,890	890	943	49,057
31/12/20X9	2,000	2,943	943	0	50,000
Totals	10,000	14,212	4,212		

At the end of 20X5, the issuer would make the following journal entry:

Dr Interest expense	CU2,747
Cr Bond discount	CU747
Cr Cash	CU2,000

Calculations

Present value of principal of CU50,000 at 6 per cent

$$CU50,000/(1.06)^5 = 37,363$$

Present value of the interest annuity of CU2,000 (=CU50,000 × 4 per cent) payable at the end of each of five years

The CU2,000 annual interest payments are an annuity—a cash flow stream with a limited number (n) of periodic payments (C), receivable at dates 1 to n. To calculate the present value of this annuity, future payments are discounted by the periodic rate of interest (i) using the following formula:

$$PV = C/i \times [1 - a/(1+i)^5]$$

Therefore, the present value of the CU2,000 interest payments is $(2,000/.06) \times [1 - [(1/1.06)^5]] = 8,425$

This is equivalent to the sum of the present values of the five individual CU2,000 payments, as follows:

	CU
Present value of interest payment at 31 December 20X5 = $2,000/1.06$	1,887
Present value of interest payment at 31 December 20X6 = $2,000/1.06^2$	1,780
Present value of interest payment at 31 December 20X7 = $2,000/1.06^3$	1,679
Present value of interest payment at 31 December 20X8 = $2,000/1.06^4$	1,584
Present value of interest payment at 31 December 20X9 = $2,000/1.06^5$	1,495
Total	8,425

Yet another way to calculate this is to use a table of present value of an ordinary annuity in arrears, five periods, interest rate of 6 per cent per period. (Such tables are easily found on the Internet.) The present value factor is 4.2124. Multiplying this by the annuity payment of CU2,000 determines the present value of CU8,425.

SECTION 23: REVENUE

SCOPE OF THIS SECTION

- 23.1 This section shall be applied in accounting for **revenue** arising from the following transactions and events:
- (a) the sale of goods (whether produced by the entity for the purpose of sale or purchased for resale).
 - (b) the rendering of services.
 - (c) construction contracts in which the entity is the contractor.
 - (d) the use by others of entity assets yielding interest, royalties or dividends.
- 23.2 Revenue or other **income** arising from some transactions and events is dealt with in other sections of this FRS:
- (a) lease agreements (see Section 20 *Leases*).
 - (b) dividends and other income arising from investments that are accounted for using the equity method (see Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures*).
 - (c) changes in the **fair value** of **financial assets** and **financial liabilities** or their disposal (see Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*).
 - (d) changes in the fair value of **investment property** (see Section 16 *Investment Property*).
 - (e) initial **recognition** and changes in the fair value of **biological assets** related to agricultural activity (see Section 34 *Specialised Activities*).

- (f) initial recognition of **agricultural produce** (see Section 34).

MEASUREMENT OF REVENUE

- 23.3 An entity shall measure revenue at the fair value of the consideration received or receivable. The fair value of the consideration received or receivable takes into account the amount of any trade discounts, prompt settlement discounts and volume rebates allowed by the entity.
- 23.4 An entity shall include in revenue only the gross inflows of economic benefits received and receivable by the entity on its own account. An entity shall exclude from revenue all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes. In an agency relationship, an entity shall include in revenue only the amount of its commission. The amounts collected on behalf of the principal are not revenue of the entity.

Deferred payment

- 23.5 When the inflow of cash or cash equivalents is deferred, and the arrangement constitutes in effect a financing transaction, the fair value of the consideration is the **present value** of all future receipts determined using an **imputed rate of interest**. A financing transaction arises when, for example, an entity provides interest-free credit to the buyer or accepts a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. The imputed rate of interest is the more clearly determinable of either:
- (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or
 - (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

An entity shall recognise the difference between the present value of all future receipts and the nominal amount of the consideration as interest revenue in accordance with paragraphs 23.28 and 23.29 and Section 11.

Exchanges of goods or services

- 23.6 An entity shall not recognise revenue:
- (a) when goods or services are exchanged for goods or services that are of a similar nature and value, or
 - (b) when goods or services are exchanged for dissimilar goods or services but the transaction lacks commercial substance.
- 23.7 An entity shall recognise revenue when goods are sold or services are exchanged for dissimilar goods or services in a transaction that has commercial substance. In that case, the entity shall measure the transaction at
- (a) the fair value of the goods or services received adjusted by the amount of any cash or cash equivalents transferred; or
 - (b) if the amount under (a) cannot be measured reliably, then at the fair value of the goods or services given up adjusted by the amount of any cash or cash equivalents transferred; or
 - (c) if the fair value of neither the asset received nor the asset given up can be measured reliably, then at the **carrying** amount of the asset given up adjusted by the amount of any cash or cash equivalents transferred.

IDENTIFICATION OF THE REVENUE TRANSACTION

- 23.8 An entity usually applies the revenue recognition criteria in this section separately to each transaction. However, an

entity applies the recognition criteria to the separately identifiable components of a single transaction when necessary to reflect the substance of the transaction. For example, an entity applies the recognition criteria to the separately identifiable components of a single transaction when the selling price of a product includes an identifiable amount for subsequent servicing. Conversely, an entity applies the recognition criteria to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity applies the recognition criteria to two or more transactions together when it sells goods and, at the same time, enters into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction.

- 23.9 Sometimes, as part of a sales transaction, an entity grants its customer a loyalty award that the customer may redeem in the future for free or discounted goods or services. In this case, in accordance with paragraph 23.8, the entity shall account for the award credits as a separately identifiable component of the initial sales transaction. The entity shall allocate the fair value of the consideration received or receivable in respect of the initial sale between the award credits and the other components of the sale. The consideration allocated to the award credits shall be measured by reference to their fair value, ie the amount for which the award credits could be sold separately.

SALE OF GOODS

- 23.10 An entity shall recognise revenue from the sale of goods when all the following conditions are satisfied:
- (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

- (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.
 - (c) the amount of revenue can be measured reliably.
 - (d) it is **probable** that the economic benefits associated with the transaction will flow to the entity.
 - (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.
- 23.11 The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a time different from the transfer of legal title or the passing of possession.
- 23.12 An entity does not recognise revenue if it retains significant risks of ownership. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:
- (a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranties.
 - (b) when the receipt of the revenue from a particular sale is contingent on the buyer selling the goods.
 - (c) when the goods are shipped subject to installation and the installation is a significant part of the contract that has not yet been completed.
 - (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract, or at the

buyer's sole discretion without any reason, and the entity is uncertain about the probability of return.

- 23.13 If an entity retains only an insignificant risk of ownership, the transaction is a sale and the entity recognises the revenue. For example, a seller recognises revenue when it retains the legal title to the goods solely to protect the collectibility of the amount due. Similarly an entity recognises revenue when it offers a refund if the customer finds the goods faulty or is not satisfied for other reasons, and the entity can estimate the returns reliably. In such cases, the entity recognises a provision for returns in accordance with Section 21 *Provisions and Contingencies*.

RENDERING OF SERVICES

- 23.14 When the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the **reporting period** (sometimes referred to as the percentage of completion method). The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:
- (a) the amount of revenue can be measured reliably.
 - (b) it is probable that the economic benefits associated with the transaction will flow to the entity.
 - (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably.
 - (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Paragraphs 23.21–23.27 provide guidance for applying the percentage of completion method.

- 23.15 When services are performed by an indeterminate number of acts over a specified period of time, an entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.
- 23.16 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, an entity shall recognise revenue only to the extent of the expenses recognised that are recoverable.

CONSTRUCTION CONTRACTS

- 23.17 When the outcome of a **construction contract** can be estimated reliably, an entity shall recognise contract revenue and contract costs associated with the construction contract as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period (often referred to as the percentage of completion method). Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectibility of billings. Paragraphs 23.21–23.27 provide guidance for applying the percentage of completion method.
- 23.18 The requirements of this section are usually applied separately to each construction contract. However, in some circumstances, it is necessary to apply this section to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.
- 23.19 When a contract covers a number of assets, the construction of each asset shall be treated as a separate construction contract when:
- (a) separate proposals have been submitted for each asset;

- (b) each asset has been subject to separate negotiation, and the contractor and customer are able to accept or reject that part of the contract relating to each asset; and
 - (c) the costs and revenues of each asset can be identified.
- 23.20 A group of contracts, whether with a single customer or with several customers, shall be treated as a single construction contract when:
- (a) the group of contracts is negotiated as a single package;
 - (b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
 - (c) the contracts are performed concurrently or in a continuous sequence.

PERCENTAGE OF COMPLETION METHOD

- 23.21 This method is used to recognise revenue from rendering services (see paragraphs 23.14–23.16) and from construction contracts (see paragraphs 23.17–23.20). An entity shall review and, when necessary, revise the estimates of revenue and costs as the service transaction or construction contract progresses.
- 23.22 An entity shall determine the stage of completion of a transaction or contract using the method that measures most reliably the work performed. Possible methods include:
- (a) the proportion that costs incurred for work performed to date bear to the estimated total costs. Costs incurred for work performed to date do not include costs relating to future activity, such as for materials or prepayments.
 - (b) surveys of work performed.

- (c) completion of a physical proportion of the service transaction or contract work.

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

- 23.23 An entity shall recognise costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset if it is probable that the costs will be recovered.
- 23.24 An entity shall recognise as an expense immediately any costs whose recovery is not probable.
- 23.25 When the outcome of a construction contract cannot be estimated reliably:
 - (a) an entity shall recognise revenue only to the extent of contract costs incurred that it is probable will be recoverable, and
 - (b) the entity shall recognise contract costs as an expense in the period in which they are incurred.
- 23.26 When it is probable that total contract costs will exceed total contract revenue on a construction contract, the expected loss shall be recognised as an expense immediately, with a corresponding provision for an onerous contract (see Section 21).
- 23.27 If the collectibility of an amount already recognised as contract revenue is no longer probable, the entity shall recognise the uncollectible amount as an expense rather than as an adjustment of the amount of contract revenue.

INTEREST, ROYALTIES AND DIVIDENDS

- 23.28 An entity shall recognise revenue arising from the use by others of entity assets yielding interest, royalties and dividends on the bases set out in paragraph 23.29 when:
- (a) it is probable that the economic benefits associated with the transaction will flow to the entity, and
 - (b) the amount of the revenue can be measured reliably.
- 23.29 An entity shall recognise revenue on the following bases:
- (a) interest shall be recognised using the **effective interest method** as described in paragraphs 11.15–11.20.
 - (b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement.
 - (c) dividends shall be recognised when the shareholder's right to receive payment is established.

DISCLOSURES

General disclosures about revenue

- 23.30 An entity shall disclose:
- (a) the **accounting policies** adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services.
 - (b) the amount of each category of revenue recognised during the period, showing separately, at a minimum, revenue arising from:
 - (i) the sale of goods.

- (ii) the rendering of services.
- (iii) interest.
- (iv) royalties.
- (v) dividends.
- (vi) commissions.
- (vii) government grants.
- (viii) any other significant types of revenue.

Disclosures relating to revenue from construction contracts

- 23.31 An entity shall disclose the following:
- (a) the amount of contract revenue recognised as revenue in the period.
 - (b) the methods used to determine the contract revenue recognised in the period.
 - (c) the methods used to determine the stage of completion of contracts in progress.
- 23.32 An entity shall present:
- (a) the gross amount due from customers for contract work, as an asset.
 - (b) the gross amount due to customers for contract work, as a liability.

APPENDIX TO SECTION 23 EXAMPLES OF REVENUE RECOGNITION UNDER THE PRINCIPLES IN SECTION 23

This Appendix accompanies, but is not part of, Section 23. It provides guidance for applying the requirements of Section 23 in recognising revenue.

- 23A.1 The following examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably, it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

SALE OF GOODS

- 23A.2 The law in different countries may cause the recognition criteria in Section 23 to be met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

Example 1 ‘Bill and hold’ sales, in which delivery is delayed at the buyer’s request but the buyer takes title and accepts billing

- 23A.3 The seller recognises revenue when the buyer takes title, provided:
- (a) it is probable that delivery will be made;
 - (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;

- (c) the buyer specifically acknowledges the deferred delivery instructions; and
- (d) the usual payment terms apply.

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

Example 2 Goods shipped subject to conditions: installation and inspection

23A.4 The seller normally recognises revenue when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

- (a) the installation process is simple, for example the installation of a factory-tested television receiver that requires only unpacking and connection of power and antennae, or
- (b) the inspection is performed only for the purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.

Example 3 Goods shipped subject to conditions: on approval when the buyer has negotiated a limited right of return

23A.5 If there is uncertainty about the possibility of return, the seller recognises revenue when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

Example 4 Goods shipped subject to conditions: consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)

23A.6 The shipper recognises revenue when the goods are sold by the recipient to a third party.

Example 5 Goods shipped subject to conditions: cash on delivery sales

- 23A.7 The seller recognises revenue when delivery is made and cash is received by the seller or its agent.

Example 6 Layaway sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments

- 23A.8 The seller recognises revenue from such sales when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received, provided the goods are on hand, identified and ready for delivery to the buyer.

Example 7 Orders when payment (or partial payment) is received in advance of delivery for goods not currently held in inventory, for example, the goods are still to be manufactured or will be delivered direct to the buyer from a third party

- 23A.9 The seller recognises revenue when the goods are delivered to the buyer.

Example 8 Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods

- 23A.10 For a sale and repurchase agreement on an asset other than a financial asset, the seller must analyse the terms of the agreement to ascertain whether, in substance, the risks and rewards of ownership have been transferred to the buyer. If they have been transferred, the seller recognises revenue. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a

financial asset, the derecognition provisions of Section 11 apply.

Example 9 Sales to intermediate parties, such as distributors, dealers or others for resale

- 23A.11 The seller generally recognises revenue from such sales when the risks and rewards of ownership have been transferred. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Example 10 Subscriptions to publications and similar items

- 23A.12 When the items involved are of similar value in each time period, the seller recognises revenue on a straight-line basis over the period in which the items are dispatched. When the items vary in value from period to period, the seller recognises revenue on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Example 11 Instalment sales, under which the consideration is receivable in instalments

- 23A.13 The seller recognises revenue attributable to the sales price, exclusive of interest, at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The seller recognises the interest element as revenue using the effective interest method.

Example 12 Agreements for the construction of real estate

- 23A.14 An entity that undertakes the construction of real estate, directly or through subcontractors, and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method, only if:
- (a) the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not), or
 - (b) the buyer acquires and supplies construction materials and the entity provides only construction services.
- 23A.15 If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver real estate to the buyer, the agreement shall be accounted for as the sale of goods. In this case, the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Rather, the transfer occurs only on delivery of the completed real estate to the buyer.

Example 13 Sale with customer loyalty award

- 23A.16 An entity sells product A for CU100. Purchasers of product A get an award credit enabling them to buy product B for CU10. The normal selling price of product B is CU18. The entity estimates that 40 per cent of the purchasers of product A will use their award to buy product B at CU10. The normal selling price of product A, after taking into account discounts that are usually offered but that are not available during this promotion, is CU95.

23A.17 The fair value of the award credit is 40 per cent \times [CU18 – CU10] = CU3.20. The entity allocates the total revenue of CU100 between product A and the award credit by reference to their relative fair values of CU95 and CU3.20 respectively. Therefore:

(a) Revenue for product A is

$$\text{CU100} \times [\text{CU95} / (\text{CU95} + \text{CU3.20})] = \text{CU96.74}$$

(b) Revenue for product B is

$$\text{CU100} \times [\text{CU3.20} / (\text{CU95} + \text{CU3.20})] = \text{CU3.26}$$

RENDERING OF SERVICES

Example 14 Installation fees

23A.18 The seller recognises installation fees as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

Example 15 Servicing fees included in the price of the product

23A.19 When the selling price of a product includes an identifiable amount for subsequent servicing (eg after sales support and product enhancement on the sale of software), the seller defers that amount and recognises it as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

Example 16 Advertising commissions

23A.20 Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

Example 17 Insurance agency commissions

- 23A.21 Insurance agency commissions received or receivable that do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the agent defers the commission, or part of it, and recognises it as revenue over the period during which the policy is in force.

Example 18 Admission fees

- 23A.22 The seller recognises revenue from artistic performances, banquets and other special events when the event takes place. When a subscription to a number of events is sold, the seller allocates the fee to each event on a basis that reflects the extent to which services are performed at each event.

Example 19 Tuition fees

- 23A.23 The seller recognises revenue over the period of instruction

Example 20 Initiation, entrance and membership fees

- 23A.24 Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty about its collectibility exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

FRANCHISE FEES

23A.25 Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate.

Example 21 Franchise fees: Supplies of equipment and other tangible assets

23A.26 The franchisor recognises the fair value of the assets sold as revenue when the items are delivered or title passes.

Example 22 Franchise fees: Supplies of initial and subsequent services

23A.27 The franchisor recognises fees for the provision of continuing services, whether part of the initial fee or a separate fee, as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

23A.28 The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (such as assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

- 23A.29 The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.
- 23A.30 If the initial fee is collectible over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

Example 23 Franchise fees: Continuing franchise fees

- 23A.31 Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

Example 24 Franchise fees: Agency transactions

- 23A.32 Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

Example 25 Fees from the development of customised software

- 23A.33 The software developer recognises fees from the development of customised software as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

INTEREST, ROYALTIES AND DIVIDENDS

Example 26 Licence fees and royalties

- 23A.34 The licensor recognises fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use specified technology for a specified period of time.
- 23A.35 An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations after delivery. Another example is the granting of rights to exhibit a motion picture film in markets in which the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.
- 23A.36 In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

SECTION 24: GOVERNMENT GRANTS

SCOPE OF THIS SECTION

- 24.1 This section specifies the accounting for all government grants. A **government grant** is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity.
- 24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.
- 24.3 This section does not cover government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates. Section 29 *Income Tax* covers accounting for taxes based on income.

RECOGNITION AND MEASUREMENT

- 24.4 An entity shall recognise government grants as follows:
- (a) A grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable.
 - (b) A grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met.
 - (c) Grants received before the revenue recognition criteria are satisfied are recognised as a liability.

- 24.5 An entity shall measure grants at the fair value of the asset received or receivable.

DISCLOSURES

- 24.6 An entity shall disclose the following about government grants:

- (a) the nature and amounts of government grants recognised in the financial statements.
- (b) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income.
- (c) an indication of other forms of government assistance from which the entity has directly benefited.

- 24.7 For the purpose of the disclosure required by paragraph 24.6(c), government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. Examples include free technical or marketing advice, the provision of guarantees, and loans at nil or low interest rates.

SECTION 25: BORROWING COSTS

SCOPE OF THIS SECTION

- 25.1 This section specifies the accounting for **borrowing costs**. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs include:
- (a) interest expense calculated using the effective interest method as described in Section 11 *Basic Financial Instruments*.
 - (b) finance charges in respect of finance leases recognised in accordance with Section 20 *Leases*.
 - (c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

RECOGNITION

- 25.2 An entity shall recognise all borrowing costs as an expense in profit or loss in the period in which they are incurred.

DISCLOSURES

- 25.3 Paragraph 5.5(b) requires disclosure of finance costs. Paragraph 11.48(b) requires disclosure of total interest expense (using the **effective interest method**) for financial liabilities that are not at fair value through profit or loss. This section does not require any additional disclosure.

SECTION 26: SHARE-BASED PAYMENT

SCOPE OF THIS SECTION

- 26.1 This section specifies the accounting for all **share-based payment transactions** including:
- (a) **equity-settled share-based payment** transactions, in which the entity acquires goods or services as consideration for **equity** instruments of the entity (including shares or share options);
 - (b) **cash-settled share-based payment** transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and
 - (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.
- 26.2 Cash-settled share-based payment transactions include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (eg upon cessation of employment) or at the employee's option.

RECOGNITION

- 26.3 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.
- 26.4 When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, the entity shall recognise them as expenses.

RECOGNITION WHEN THERE ARE VESTING CONDITIONS

- 26.5 If the share-based payments granted to employees **vest** immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those share-based payments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the employee as consideration for the share-based payments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity or liabilities.
- 26.6 If the share-based payments do not vest until the employee completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those share-based payments will be received in the future, during the vesting period. The entity shall account for those services as they are rendered by the employee during the vesting period, with a corresponding increase in equity or liabilities.

MEASUREMENT OF EQUITY-SETTLED SHARE-BASED PAYMENT TRANSACTIONS

Measurement principle

- 26.7 For equity-settled share-based payment transactions, an entity shall measure the goods or services received, and the corresponding increase in equity, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received.
- 26.8 For transactions with employees (including others providing similar services), the fair value of the equity instruments shall be measured at grant date. For transactions with parties other than employees, the measurement date is the date when the entity obtains the goods or the counterparty renders service.
- 26.9 A grant of equity instruments might be conditional on employees satisfying specified vesting conditions related to service or performance. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a market vesting condition). All vesting conditions related to solely employee service or to a non-market performance condition shall be taken into account when estimating the number of equity instruments expected to vest.

Subsequently, the entity shall revise that estimate, if necessary, if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. All market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the shares or share options at the measurement date, with no subsequent adjustment irrespective of the outcome.

Shares

- 26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:
- (a) If an observable market price is available for the equity instruments granted, use that price.
 - (b) If an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as
 - (i) a recent transaction in the entity's shares, or
 - (ii) a recent independent fair valuation of the entity or its principal assets.
 - (c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is **impracticable**, indirectly measure the fair value of the shares or share appreciation rights using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value. Any valuation method

used should be consistent with generally accepted valuation methodologies for valuing equity instruments.

Share options and equity-settled share appreciation rights

- 26.11 An entity shall measure the fair value of share options and equity-settled share appreciation rights (and the related goods or services received) using the following three-tier measurement hierarchy:
- (a) If an observable market price is available for the equity instruments granted, use that price.
 - (b) If an observable market price is not available, measure the fair value of share options and share appreciation rights granted using entity-specific observable market data such as (a) for a recent transaction in the share options.
 - (c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an option pricing model. The inputs for the model (such as the weighted average share price, exercise price, expected volatility, option life, expected dividends, and the risk-free interest rate) should use market data to the greatest extent possible. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity should derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Modifications to the terms and conditions on which equity instruments were granted

- 26.12 If an entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by reducing the

exercise price of an option or reducing the vesting period or by modifying or eliminating a performance condition, the entity shall take the modified vesting conditions into account in accounting for the share-based payment transaction, as follows:

- (a) If the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.
- (b) If the modification reduces the total fair value of the share-based payment arrangement, or apparently is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred.

Cancellations and settlements

- 26.13 An entity shall account for a cancellation or settlement of an equity-settled share-based payment award as an acceleration of vesting, and therefore shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS

- 26.14 For cash-settled share-based payment transactions, an entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each **reporting date** and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

SHARE-BASED PAYMENT TRANSACTIONS WITH CASH ALTERNATIVES

- 26.15 Some share-based payment transactions give either the entity or the counterparty a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments. In such a case, the entity shall account for the transaction as a cash-settled share-based payment transaction unless either
- (a) the entity has a past practice of settling by issuing equity instruments, or
 - (b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument.

In circumstances (a) and (b), the entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraphs 26.7–26.13.

GROUP PLANS

- 26.16 If a share-based payment award is granted by a **parent** entity to the employees of one or more **subsidiaries** in the group, and the parent presents consolidated financial statements using either the *FRSME* or **EU-adopted IFRS**, such subsidiaries are permitted to recognise and

measure share-based payment expense (and the related capital contribution by the parent) on the basis of a reasonable allocation of the expense recognised for the group.

GOVERNMENT-MANDATED PLANS

- 26.17 Some jurisdictions have programmes established under law by which equity investors (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). This indicates that other consideration has been or will be received (such as past or future employee services). These are equity-settled share-based payment transactions within the scope of this section. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date.

DISCLOSURES

- 26.18 An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period:
- (a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (eg whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.
 - (b) the number and weighted average exercise prices of share options for each of the following groups of options:

- (i) outstanding at the beginning of the period.
 - (ii) granted during the period.
 - (iii) forfeited during the period.
 - (iv) exercised during the period.
 - (v) expired during the period.
 - (vi) outstanding at the end of the period.
 - (vii) exercisable at the end of the period.
- 26.19 For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.
- 26.20 For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.
- 26.21 For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.
- 26.22 If the entity is part of a group share-based payment plan, and it recognises and measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).
- 26.23 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position:

- (a) the total expense recognised in profit or loss for the period.
- (b) the total carrying amount at the end of the period for liabilities arising from share-based payment transactions.

SECTION 27: IMPAIRMENT OF ASSETS

OBJECTIVE AND SCOPE

- 27.1 An **impairment loss** occurs when the **carrying amount** of an asset exceeds its **recoverable amount**. This section shall be applied in accounting for the impairment of all assets other than the following, for which other sections of this FRS establish impairment requirements:
- (a) **deferred tax assets** (see Section 29 *Income Tax*).
 - (b) assets arising from **employee benefits** (see Section 28 *Employee Benefits*).
 - (c) **financial assets** within the scope of Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instruments Issues*.
 - (d) **investment property** measured at **fair value** (see Section 16 *Investment Property*).
 - (e) **biological assets** related to agricultural activity measured at fair value less estimated costs to sell (see Section 34 *Specialised Activities*).

IMPAIRMENT OF INVENTORIES

Selling price less costs to complete and sell

- 27.2 An entity shall assess at each **reporting date** whether any inventories are impaired. The entity shall make the assessment by comparing the **carrying amount** of each item of inventory (or group of similar items—see paragraph 27.3) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, the entity shall reduce the carrying amount of the inventory (or the group) to its selling price less costs to complete and

sell. That reduction is an impairment loss and it is recognised immediately in profit or loss.

- 27.3 If it is **impracticable** to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area for the purpose of assessing impairment.

Reversal of impairment

- 27.4 An entity shall make a new assessment of selling price less costs to complete and sell at each subsequent reporting date. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss) so that the new carrying amount is the lower of the cost and the revised selling price less costs to complete and sell.

IMPAIRMENT OF ASSETS OTHER THAN INVENTORIES

General principles

- 27.5 If, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss. Paragraphs 27.11–27.20 provide guidance on measuring recoverable amount.
- 27.6 An entity shall recognise an impairment loss immediately in profit or loss.

Indicators of impairment

- 27.7 An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.
- 27.8 If it is not possible to estimate the recoverable amount of the individual asset, an entity shall estimate the recoverable amount of the **cash-generating unit** to which the asset belongs. This may be the case because measuring recoverable amount requires forecasting cash flows, and sometimes individual assets do not generate cash flows by themselves. An asset's cash-generating unit is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
- 27.9 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

- (a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.
- (b) Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
- (c) Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect materially the discount rate used in calculating an asset's value in use and decrease the asset's fair value less costs to sell.

- (d) The carrying amount of the net assets of the entity is more than the estimated fair value of the entity as a whole (such an estimate may have been made, for example, in relation to the potential sale of part or all of the entity).

Internal sources of information

- (e) Evidence is available of obsolescence or physical damage of an asset.
- (f) Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.
- (g) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.

- 27.10 If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful life, the **depreciation (amortisation)** method or the **residual value** for the asset and adjust it in accordance with the section of this FRS applicable to the asset (eg Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring recoverable amount

- 27.11 The recoverable amount of an asset or a cash-generating unit is the higher of its **fair value less costs to sell** and its

value in use. If it is not possible to estimate the recoverable amount of an individual asset, references in paragraphs 27.12–27.20 to an asset should be read as references also to an asset’s cash-generating unit.

- 27.12 It is not always necessary to determine both an asset’s fair value less costs to sell and its value in use. If either of these amounts exceeds the asset’s carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
- 27.13 If there is no reason to believe that an asset’s value in use materially exceeds its fair value less costs to sell, the asset’s fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal.

Fair value less costs to sell

- 27.14 Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal. The best evidence of the fair value less costs to sell of an asset is a price in a binding sale agreement in an arm’s length transaction or a market price in an active market. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm’s length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry.

Value in use

- 27.15 Value in use is the **present value** of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:

- (a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal, and
 - (b) applying the appropriate discount rate to those future cash flows.
- 27.16 The following elements shall be reflected in the calculation of an asset's value in use:
- (a) an estimate of the future cash flows the entity expects to derive from the asset.
 - (b) expectations about possible variations in the amount or timing of those future cash flows.
 - (c) the time value of money, represented by the current market risk-free rate of interest.
 - (d) the price for bearing the uncertainty inherent in the asset.
 - (e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.
- 27.17 In measuring value in use, estimates of future cash flows shall include:
- (a) projections of cash inflows from the continuing use of the asset.
 - (b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset.

- (c) net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life in an arm's length transaction between knowledgeable, willing parties.

The entity may wish to use any recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity may wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

- 27.18 Estimates of future cash flows shall not include:
- (a) cash inflows or outflows from financing activities, or
 - (b) income tax receipts or payments.
- 27.19 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:
- (a) a future restructuring to which an entity is not yet committed, or
 - (b) improving or enhancing the asset's performance.
- 27.20 The discount rate (rates) used in the present value calculation shall be a pre-tax rate (rates) that reflect(s) current market assessments of:
- (a) the time value of money, and
 - (b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

The discount rate (rates) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

Recognising and measuring an impairment loss for a cash-generating unit

- 27.21 An impairment loss shall be recognised for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:
- (a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit, and
 - (b) then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the cash-generating unit.
- 27.22 However, an entity shall not reduce the carrying amount of any asset in the cash-generating unit below the highest of:
- (a) its fair value less costs to sell (if determinable);
 - (b) its value in use (if determinable); and
 - (c) zero.
- 27.23 Any excess amount of the impairment loss that cannot be allocated to an asset because of the restriction in paragraph 27.22 shall be allocated to the other assets of the unit pro rata on the basis of the carrying amount of those other assets.

**ADDITIONAL REQUIREMENTS FOR
IMPAIRMENT OF GOODWILL**

- 27.24 Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash

flows of other assets. As a consequence, the fair value of goodwill cannot be measured directly. Therefore, the fair value of goodwill must be derived from measurement of the fair value of the cash-generating unit(s) of which the goodwill is a part.

- 27.25 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.
- 27.26 Part of the recoverable amount of a cash-generating unit is attributable to the non-controlling interest in goodwill. For the purpose of impairment testing a non-wholly-owned cash-generating unit with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.
- 27.27 If goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then for the purposes of testing goodwill the entity shall test the impairment of goodwill by determining the recoverable amount of either (a) or (b):
- (a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated. Integrated means the acquired business has been restructured or dissolved into the reporting entity or other subsidiaries.
 - (b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.

In applying this paragraph, an entity will need to separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities that have not been integrated. Also the entity shall follow the requirements for cash-generating units in this section when calculating the recoverable amount of, and allocating impairment losses and reversals to assets belonging to, the acquired entity or group of entities.

Reversal of an impairment loss

- 27.28 An impairment loss recognised for goodwill shall be reversed in a subsequent period if and only if the reasons for the impairment loss have ceased to apply.
- 27.29 For all assets other than goodwill, an entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 27.9. If any such indication exists, the entity shall determine whether all or part of the prior impairment loss should be reversed. The procedure for making that determination will depend on whether the prior impairment loss on the asset was based on:
- (a) the recoverable amount of that individual asset (see paragraph 27.30), or
 - (b) the recoverable amount of the cash-generating unit to which the asset belongs (see paragraph 27.31).

Reversal where recoverable amount was estimated for an individual impaired asset

- 27.30 When the prior impairment loss was based on the recoverable amount of the individual impaired asset, the following requirements apply:

- (a) The entity shall estimate the recoverable amount of the asset at the current reporting date.
- (b) If the estimated recoverable amount of the asset exceeds its carrying amount, the entity shall increase the carrying amount to recoverable amount, subject to the limitation described in (c) below. That increase is a reversal of an impairment loss. The entity shall recognise the reversal immediately in profit or loss.
- (c) The reversal of an impairment loss shall not increase the carrying amount of the asset above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.
- (d) After a reversal of an impairment loss is recognised, the entity shall adjust the depreciation (amortisation) charge for the asset in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal when recoverable amount was estimated for a cash-generating unit

- 27.31 When the original impairment loss was based on the recoverable amount of the cash-generating unit to which the asset belongs, the following requirements apply:
- (a) The entity shall estimate the recoverable amount of that cash-generating unit at the current reporting date.
 - (b) If the estimated recoverable amount of the cash-generating unit exceeds its carrying amount, that excess is a reversal of an impairment loss. The entity shall allocate the amount of that reversal to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets, subject to the limitation described in (c) below. Those increases in carrying amounts shall be treated as reversals of impairment

losses for individual assets and recognised immediately in profit or loss.

- (c) In allocating a reversal of an impairment loss for a cash-generating unit, the reversal shall not increase the carrying amount of any asset above the lower of
 - (i) its recoverable amount, and
 - (ii) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.
- (d) Any excess amount of the reversal of the impairment loss that cannot be allocated to an asset because of the restriction in (c) above shall be allocated pro rata to the other assets of the cash-generating unit, except for goodwill.
- (e) After a reversal of an impairment loss is recognised, if applicable, the entity shall adjust the depreciation (amortisation) charge for each asset in the cash-generating unit in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

DISCLOSURES

27.32 An entity shall disclose the following for each **class of assets** indicated in paragraph 27.33:

- (a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are included.
- (b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s)

in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are reversed.

27.33 An entity shall disclose the information required by paragraph 27.32 for each of the following classes of asset:

- (a) inventories.
- (b) property, plant and equipment (including investment property accounted for by the cost method).
- (c) goodwill.
- (d) intangible assets other than goodwill.
- (e) investments in associates.
- (f) investments in joint ventures.

SECTION 28: EMPLOYEE BENEFITS

SCOPE OF THIS SECTION

- 28.1 Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to all employee benefits, except for **share-based payment transactions**, which are covered by Section 26 *Share-based Payment*. Employee benefits covered by this section will be one of the following four types:
- (a) short-term employee benefits, which are employee benefits (other than **termination benefits**) that are wholly due within twelve months after the end of the period in which the employees render the related service.
 - (b) **post-employment benefits**, which are employee benefits (other than termination benefits) that are payable after the completion of employment.
 - (c) other long-term employee benefits, which are employee benefits (other than post-employment benefits and termination benefits) that are not wholly due within twelve months after the end of the period in which the employees render the related service.
 - (d) termination benefits, which are employee benefits payable as a result of either:
 - (i) an entity's decision to terminate an employee's employment before the normal retirement date, or
 - (ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.

- 28.2 Employee benefits also include share-based payment transactions by which employees receive equity instruments (such as shares or share options) or cash or other assets of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity. An entity shall apply Section 26 in accounting for share-based payment transactions.

GENERAL RECOGNITION PRINCIPLE FOR ALL EMPLOYEE BENEFITS

- 28.3 An entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the entity during the **reporting period**:
- (a) as a liability, after deducting amounts that have been paid either directly to the employees or as a contribution to an employee benefit fund. If the amount paid exceeds the obligation arising from service before the **reporting date**, an entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.
 - (b) as an expense, unless another section of this FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

SHORT-TERM EMPLOYEE BENEFITS

Examples

- 28.4 Short-term employee benefits include items such as:
- (a) wages, salaries and social security contributions;
 - (b) short-term compensated absences (such as paid annual leave and paid sick leave) when the absences are

expected to occur within twelve months after the end of the period in which the employees render the related employee service;

- (c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and
- (d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits generally

- 28.5 When an employee has rendered service to an entity during the reporting period, the entity shall measure the amounts recognised in accordance with paragraph 28.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement—short-term compensated absences

- 28.6 An entity may compensate employees for absence for various reasons including annual vacation leave and sick leave. Some short-term compensated absences accumulate—they can be carried forward and used in future periods if the employee does not use the current period's entitlement in full. Examples include annual vacation leave and sick leave. An entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The entity shall measure the expected cost of accumulating compensated absences at the undiscounted additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The entity shall present this amount as a **current liability** at the reporting date.

- 28.7 An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition—profit-sharing and bonus plans

- 28.8 An entity shall recognise the expected cost of profit-sharing and bonus payments only when:
- (a) the entity has a present legal or **constructive obligation** to make such payments as a result of past events (this means that the entity has no realistic alternative but to make the payments), and
 - (b) a reliable estimate of the obligation can be made.

**POST-EMPLOYMENT BENEFITS:
DISTINCTION BETWEEN DEFINED
CONTRIBUTION PLANS AND DEFINED
BENEFIT PLANS**

- 28.9 Post-employment benefits include, for example:
- (a) retirement benefits, such as pensions, and
 - (b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are **post-employment benefit plans**. An entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law rather than by action of the entity. In some

cases, these arrangements arise from actions of the entity even in the absence of a formal, documented plan.

- 28.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on their principal terms and conditions.
- (a) Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurer, together with investment returns arising from the contributions.
- (b) Defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the entity's obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more or less than expected) and investment risk (that returns on assets set aside to fund the benefits will differ from expectations) are borne, in substance, by the entity. If actuarial or investment experience is worse than expected, the entity's obligation may be increased, and vice versa if actuarial or investment experience is better than expected.

Multi-employer plans and state plans

- 28.11 Multi-employer plans and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive

obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall account for the plan in accordance with paragraph 28.13 as if it was a defined contribution plan and make the disclosures required by paragraph 28.40.

Insured benefits

- 28.12 An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity has a legal or constructive obligation either:
- (a) to pay the employee benefits directly when they become due, or
 - (b) to pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

A constructive obligation could arise indirectly through the plan, through the mechanism for setting future premiums, or through a **related party** relationship with the insurer. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

POST-EMPLOYMENT BENEFITS: DEFINED CONTRIBUTION PLANS

Recognition and measurement

- 28.13 An entity shall recognise the contribution payable for a period:
- (a) as a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, an entity shall recognise that excess as an asset.

- (b) as an expense, unless another section of this FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment

POST-EMPLOYMENT BENEFITS: DEFINED BENEFIT PLANS

Recognition

- 28.14 In applying the general recognition principle in paragraph 28.3 to defined benefit plans, an entity shall recognise:
- (a) a liability for its obligations under defined benefit plans net of plan assets—its ‘**defined benefit liability**’ (see paragraphs 28.15–28.23).
 - (b) recognises the net change in that liability during the period as the cost of its defined benefit plans during the period (see paragraphs 28.24–28.27).

Measurement of the defined benefit liability

- 28.15 An entity shall measure a defined benefit liability for its obligations under defined benefit plans at the net total of the following amounts:
- (a) the **present value** of its obligations under defined benefit plans (its **defined benefit obligation**) at the reporting date (paragraphs 28.16–28.22 provide guidance for measuring this obligation), minus
 - (b) the fair value at the reporting date of **plan assets** (if any) out of which the obligations are to be settled directly. Paragraphs 11.27–11.32 establish requirements for determining the fair values of those plan assets that are **financial assets**.

Inclusion of both vested and unvested benefits

- 28.16 The present value of an entity's obligations under defined benefit plans at the reporting date shall reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet **vested** (see paragraph 28.26) and including the effects of benefit formulas that give employees greater benefits for later years of service. This requires the entity to determine how much benefit is attributable to the current and prior periods on the basis of the plan's benefit formula and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that influence the cost of the benefit. The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible, and selected to lead to the best estimate of the future cash flows that will arise under the plan.

Discounting

- 28.17 An entity shall measure its defined benefit obligation on a discounted **present value** basis. The entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. In countries with no deep market in such bonds, the entity shall use the market yields (at the reporting date) on government bonds. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

Actuarial valuation method

- 28.18 If an entity is able, without undue cost or effort, to use the **projected unit credit method** to measure its defined benefit obligation and the related expense, it shall do so. If defined benefits are based on future salaries, the projected

unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases. Additionally, the projected unit credit method requires an entity to make various actuarial assumptions in measuring the defined benefit obligation, including discount rates, the expected rates of return on plan assets, expected rates of salary increases, employee turnover, mortality, and (for defined benefit medical plans) medical cost trend rates.

28.19 If an entity is not able, without undue cost or effort, to use the projected unit credit method to measure its obligation and cost under defined benefit plans, the entity is permitted to make the following simplifications in measuring its defined benefit obligation with respect to current employees:

- (a) ignore estimated future salary increases (ie assume current salaries continue until current employees are expected to begin receiving post-employment benefits);
- (b) ignore future service of current employees (ie assume closure of the plan for existing as well as any new employees); and
- (c) ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits (ie assume all current employees will receive the post-employment benefits). However, mortality after service (ie life expectancy) will still need to be considered.

An entity that takes advantage of the foregoing measurement simplifications must nonetheless include both vested and unvested benefits in measuring its defined benefit obligation.

- 28.20 This FRS does not require an entity to engage an independent actuary to perform the comprehensive actuarial valuation needed to calculate its defined benefit obligation. Nor does it require that a comprehensive actuarial valuation must be done annually. In the periods between comprehensive actuarial valuations, if the principal actuarial assumptions have not changed significantly the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics such as number of employees and salary levels.

Plan introductions, changes, curtailments and settlements

- 28.21 If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (income) in measuring profit or loss in the current period. Conversely, if a plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged) in the current period, the defined benefit obligation shall be decreased or eliminated, and the entity shall recognise the resulting gain or loss in profit or loss in the current period.

Defined benefit plan asset

- 28.22 If the present value of the defined benefit obligation at the reporting date is less than the fair value of plan assets at that date, the plan has a surplus. An entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Cost of a defined benefit plan

- 28.23 An entity shall recognise the net change in its defined benefit liability during the period, other than a change

attributable to benefits paid to employees during the period or to contributions from the employer, as the cost of its defined benefit plans during the period. That cost is recognised either entirely in profit or loss as an expense or partly in profit or loss and partly as an item of other comprehensive income (see paragraph 28.24) unless another section of this FRS requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Recognition—accounting policy election

28.24 An entity is required to recognise all actuarial gains and losses in the period in which they occur. An entity shall:

- (a) not used
- (b) recognise all actuarial gains and losses in other comprehensive income

Actuarial gains and losses recognised in other comprehensive income shall be presented in the statement of comprehensive income.

28.25 The net change in the defined benefit liability that is recognised as the cost of a defined benefit plan includes:

- (a) the change in the defined benefit liability arising from employee service rendered during the reporting period.
- (b) interest on the defined benefit obligation during the reporting period.
- (c) the returns on any plan assets and the net change in the fair value of recognised reimbursement rights (see paragraph 28.28) during the reporting period.
- (d) actuarial gains and losses arising in the reporting period.

- (e) increases or decreases in the defined benefit liability resulting from introducing a new plan or changing an existing plan in the reporting period (see paragraph 28.21).
 - (f) decreases in the defined benefit liability resulting from curtailing or settling an existing plan in the reporting period (see paragraph 28.21).
- 28.26 Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not yet vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy vesting requirements. Similarly, although some post-employment benefits (such as post-employment medical benefits) become payable only if a specified event occurs when an employee is no longer employed (such as an illness), an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.
- 28.27 If defined benefits are reduced for amounts that will be paid to employees under government-sponsored plans, an entity shall measure its defined benefit obligations on a basis that reflects the benefits payable under the government plans, but only if:
- (a) those plans were enacted before the reporting date, or
 - (b) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

Reimbursements

- 28.28 If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value.

OTHER LONG-TERM EMPLOYEE BENEFITS

- 28.29 Other long-term employee benefits include, for example:
- (a) long-term compensated absences such as long-service or sabbatical leave.
 - (b) long-service benefits.
 - (c) long-term disability benefits.
 - (d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service.
 - (e) deferred compensation paid twelve months or more after the end of the period in which it is earned.
- 28.30 An entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:
- (a) the present value of the benefit obligation at the reporting date, minus
 - (b) the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

An entity shall recognise the change in the liability in accordance with paragraph 28.23.

TERMINATION BENEFITS

28.31 An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits.

Recognition

28.32 Because termination benefits do not provide an entity with future economic benefits, an entity shall recognise them as an expense in profit or loss immediately.

28.33 When an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits.

28.34 An entity shall recognise termination benefits as a liability and an expense only when the entity is demonstrably committed either:

- (a) to terminate the employment of an employee or group of employees before the normal retirement date, or
- (b) to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

28.35 An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal from the plan.

Measurement

28.36 An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the

measurement of termination benefits shall be based on the number of employees expected to accept the offer.

- 28.37 When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their discounted present value.

GROUP PLANS

- 28.38 If a **parent** entity provides benefits to the employees of one or more **subsidiaries** in the group, and the parent presents consolidated financial statements using either the *FRSME* or **EU-adopted IFRS**, such subsidiaries are permitted to recognise and measure employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group.

DISCLOSURES

Disclosures about short-term employee benefits

- 28.39 This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

- 28.40 An entity shall disclose the amount recognised in profit or loss as an expense for defined contribution plans. If an entity treats a defined benefit multi-employer plan as a defined contribution plan because sufficient information is not available to use defined benefit accounting (see paragraph 28.11) it shall disclose the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan's surplus or deficit and the implications, if any, for the entity.

Disclosures about defined benefit plans

- 28.41 An entity shall disclose the following information about defined benefit plans (except for any defined multi-employer benefit plans that are accounted for as a defined contribution plans in accordance with paragraph 28.11, for which the disclosures in paragraph 28.40 apply instead). If an entity has more than one defined benefit plan, these disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful:
- (a) a general description of the type of plan, including funding policy.
 - (b) the entity's accounting policy for recognising actuarial gains and losses and the amount of actuarial gains and losses recognised during the period.
 - (c) a narrative explanation if the entity uses any of the simplifications in paragraph 28.19 in measuring its defined benefit obligation.
 - (d) the date of the most recent comprehensive actuarial valuation and, if it was not as of the reporting date, a description of the adjustments that were made to measure the defined benefit obligation at the reporting date.
 - (e) a reconciliation of opening and closing balances of the defined benefit obligation showing separately benefits paid and all other changes.
 - (f) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, if applicable:
 - (i) contributions;
 - (ii) benefits paid; and

- (iii) other changes in plan assets.
- (g) the total cost relating to defined benefit plans for the period, disclosing separately the amounts
 - (i) recognised in profit or loss as an expense, and
 - (ii) included in the cost of an asset.
- (h) for each major class of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major class constitutes of the fair value of the total plan assets at the reporting date.
- (i) the amounts included in the fair value of plan assets for:
 - (i) each class of the entity's own financial instruments, and
 - (ii) any property occupied by, or other assets used by, the entity.
- (j) the actual return on plan assets.
- (k) the principal actuarial assumptions used, including, when applicable:
 - (i) the discount rates;
 - (ii) the expected rates of return on any plan assets for the periods presented in the financial statements;
 - (iii) the expected rates of salary increases;
 - (iv) medical cost trend rates; and
 - (v) any other material actuarial assumptions used.

The reconciliations in (e) and (f) above need not be presented for prior periods. A subsidiary that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group (see paragraph 28.38) shall, in its separate financial statements, describe its policy for making the allocation and shall make the disclosures in (a)–(k) above for the plan as a whole.

Disclosures about other long-term benefits

- 28.42 For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of **funding** at the reporting date.

Disclosures about termination benefits

- 28.43 For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, its accounting policy, and the amount of its obligation and the extent of funding at the reporting date.
- 28.44 When there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Section 21 *Provisions and Contingencies* requires an entity to disclose information about its contingent liabilities unless the possibility of an outflow in settlement is remote.

SECTION 29: INCOME TAX

SCOPE OF THIS SECTION

29.1 This Section shall be applied in accounting for income taxes.

29.2 For the purposes of this Section, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

29.3 [not used]

29.4 This Section does not deal with the methods of accounting for government grants (see Section 24 *Government Grants*) or investment tax credits. However, this Section does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

Definitions

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

Accounting profit is profit or loss for a period before deducting tax expense.

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

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

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

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:

- (a) deductible temporary differences;
- (b) the carryforward of unused tax losses; and
- (c) the carryforward of unused tax credits.

Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary differences may be either:

- (a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
- (b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

The *tax base* of an asset or liability is the amount attributed to that asset or liability for tax purposes.

29.6 Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

Tax base

29.7 The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Examples

1 A machine cost 100. For tax purposes, depreciation of 30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. *The tax base of the machine is 70.*

2 Interest receivable has a carrying amount of 100. The related interest revenue will be taxed on a cash basis. *The tax base of the interest receivable is nil.*

3 Trade receivables have a carrying amount of 100. The related revenue has already been included in taxable profit (tax loss). *The tax base of the trade receivables is 100.*

4 Dividends receivable from a subsidiary have a carrying amount of 100. The dividends are not taxable. *In substance, the entire carrying amount of the asset is deductible against the economic benefits. Consequently, the tax base of the dividends receivable is 100.*(a)

5 A loan receivable has a carrying amount of 100. The repayment of the loan will have no tax consequences. *The tax base of the loan is 100.*

(a) Under this analysis, there is no taxable temporary difference. An alternative analysis is that the accrued dividends receivable have a tax base of nil and that a tax rate of nil is applied to the resulting taxable temporary difference of 100. Under both analyses, there is no deferred tax liability.

29.8 The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

Examples

1 Current liabilities include accrued expenses with a carrying amount of 100. The related expense will be deducted for tax purposes on a cash basis. *The tax base of the accrued expenses is nil.*

2 Current liabilities include interest revenue received in advance, with a carrying amount of 100. The related interest revenue was taxed on a cash basis. *The tax base of the interest received in advance is nil.*

3 Current liabilities include accrued expenses with a carrying amount of 100. The related expense has already been deducted for tax purposes. *The tax base of the accrued expenses is 100.*

4 Current liabilities include accrued fines and penalties with a carrying amount of 100. Fines and penalties are not deductible for tax purposes.

The tax base of the accrued fines and penalties is 100.^(a)

5 A loan payable has a carrying amount of 100. The repayment of the loan will have no tax consequences. *The tax base of the loan is 100.*

(a) Under this analysis, there is no deductible temporary difference. An alternative analysis is that the accrued fines and penalties payable have a tax base of nil and that a tax rate of nil is applied to the resulting deductible temporary difference of 100. Under both analyses, there is no deferred tax asset.

29.9 Some items have a tax base but are not recognised as assets and liabilities in the statement of financial position. For example, research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset.

29.10 Where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this FRS is based: that an entity shall, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences.

Example C following paragraph 29.52 illustrates circumstances when it may be helpful to consider this fundamental principle, for example, when the tax base of an

asset or liability depends on the expected manner of recovery or settlement.

- 29.11 In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each entity in the group.

Recognition of current tax liabilities and current tax assets

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

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

- 29.14 When a tax loss is used to recover current tax of a previous period, an entity recognises the benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the entity and the benefit can be reliably measured.

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

- 29.15 A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

- (b) the initial recognition of an asset or liability in a transaction which:
 - (i) is not a business combination; and
 - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability shall be recognised in accordance with paragraph 29.39.

29.16 It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. This makes it probable that economic benefits will flow from the entity in the form of tax payments. Therefore, this FRS requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 29.15 and 29.39.

Examples

An asset which cost 150 has a carrying amount of 100. Cumulative depreciation for tax purposes is 90 and the tax rate is 25%.

The tax base of the asset is 60 (cost of 150 less cumulative tax depreciation of 90). To recover the carrying amount of 100, the entity must earn taxable income of 100, but will only be able to deduct tax depreciation of 60. Consequently, the entity will pay income taxes of 10 (40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of 100 and the tax base of 60 is a taxable temporary difference of 40. Therefore, the entity recognises a deferred tax liability of 10 (40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

29.17 Some temporary differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences. The following are examples of temporary differences of this kind which are taxable temporary differences and which therefore result in deferred tax liabilities:

- (a) interest revenue is included in accounting profit on a time proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable recognised in the statement of financial position with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected; and
- (b) depreciation used in determining taxable profit (tax loss) may differ from that used in determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base which is the original cost of the asset

less all deductions in respect of that asset permitted by the taxation authorities in determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated (if tax depreciation is less rapid than accounting depreciation, a deductible temporary difference arises, and results in a deferred tax asset).

29.18 Temporary differences also arise when:

- (a) the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with Section 19 *Business Combinations and Goodwill*, but no equivalent adjustment is made for tax purposes (see paragraph 29.19);
- (b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 29.20);
- (c) goodwill arises in a business combination (see paragraph 29.21);
- (d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an entity benefits from non-taxable government grants related to assets (see paragraphs 29.22 and 29.33); or
- (e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures becomes different from the tax base of the investment or interest (see paragraphs 29.38–29.45).

Business combinations

29.19 With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary

differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 29.66).

Assets carried at fair value

29.20 This FRS permits or requires certain assets to be carried at fair value or to be revalued (see, for example, Section 12 *Other Financial Instruments Issues* and Section 16 *Investment Property*). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

- (a) the entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or
- (b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In

such cases, the tax will ultimately become payable on sale or use of the similar assets.

Goodwill

29.21 Goodwill arising in a business combination is measured as the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 19.14.

Many taxation authorities do not allow reductions in the carrying amount of goodwill as a deductible expense in determining taxable profit. Moreover, in such jurisdictions, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such jurisdictions, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Section does not permit the recognition of the resulting deferred tax liability because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

29.21A Subsequent reductions in a deferred tax liability that is unrecognised because it arises from the initial recognition of goodwill are also regarded as arising from the initial recognition of goodwill and are therefore not recognised under paragraph 15(a). For example, if in a business combination an entity recognises goodwill of CU100 that has a tax base of nil, paragraph 15(a) prohibits the entity from recognising the resulting deferred tax liability. If the entity subsequently recognises an impairment loss of CU20 for that goodwill, the amount of the taxable temporary difference relating to the goodwill is reduced from CU100 to CU80, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is also regarded as relating to the initial recognition of the

goodwill and is therefore prohibited from being recognised under paragraph 29.15(a).

29.21B Deferred tax liabilities for taxable temporary differences relating to goodwill are, however, recognised to the extent they do not arise from the initial recognition of goodwill. For example, if in a business combination an entity recognises goodwill of CU100 that is deductible for tax purposes at a rate of 20 per cent per year starting in the year of acquisition, the tax base of the goodwill is CU100 on initial recognition and CU80 at the end of the year of acquisition. If the carrying amount of goodwill at the end of the year of acquisition remains unchanged at CU100, a taxable temporary difference of CU20 arises at the end of that year. Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.

Initial recognition of an asset or liability

29.22 A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction that led to the initial recognition of the asset or liability:

- (a) in a business combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill or bargain purchase gain it recognises (see paragraph 29.19);
- (b) if the transaction affects either accounting profit or taxable profit, an entity recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in profit or loss (see paragraph 29.59);
- (c) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an

entity would, in the absence of the exemption provided by paragraphs 29.5 and 29.24, recognise the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent. Therefore, this FRS does not permit an entity to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example below). Furthermore, an entity does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.

Example illustrating paragraph 29.22(c)

An entity intends to use an asset which cost 1,000 throughout its useful life of five years and then dispose of it for a residual value of nil. The tax rate is 40%. Depreciation of the asset is not deductible for tax purposes. On disposal, any capital gain would not be taxable and any capital loss would not be deductible.

As it recovers the carrying amount of the asset, the entity will earn taxable income of 1,000 and pay tax of 400. The entity does not recognise the resulting deferred tax liability of 400 because it results from the initial recognition of the asset. In the following year, the carrying amount of the asset is 800. In earning taxable income of 800, the entity will pay tax of 320. The entity does not recognise the deferred tax liability of 320 because it results from the initial recognition of the asset

29.23 In accordance with Section 22 *Liabilities and Equity* the issuer of a compound financial instrument (for example, a convertible bond) classifies the instrument's liability component as a liability and the equity component as equity. In some jurisdictions, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference

arises from the initial recognition of the equity component separately from the liability component. Therefore, the exception set out in paragraph 29.15(b) does not apply. Consequently, an entity recognises the resulting deferred tax liability. In accordance with paragraph 29.61A, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 29.58, subsequent changes in the deferred tax liability are recognised in profit or loss as deferred tax expense (income).

Deductible temporary differences

29.24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; and
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset shall be recognised in accordance with paragraph 29.44.

29.25 It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future

periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods.

Example

An entity recognises a liability of 100 for accrued product warranty costs.

For tax purposes, the product warranty costs will not be deductible until the entity pays claims. The tax rate is 25%. *The tax base of the liability is nil (carrying amount of 100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an amount of 100 and, consequently, reduce its future tax payments by 25 (100 at 25%). The difference between the carrying amount of 100 and the tax base of nil is a deductible temporary difference of 100. Therefore, the entity recognises a deferred tax asset of 25 (100 at 25%), provided that it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.*

29.26 The following are examples of deductible temporary differences that result in deferred tax assets:

- (a) retirement benefit costs may be deducted in determining accounting profit as service is provided by the employee, but deducted in determining taxable profit either when contributions are paid to a fund by the entity or when retirement benefits are paid by the entity. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset as economic benefits will flow to the entity in the form of

a deduction from taxable profits when contributions or retirement benefits are paid;

(b) research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset;

(c) with limited exceptions, an entity recognises the identifiable assets acquired and liabilities assumed in a business combination at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 29.66); and

(d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 29.20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

29.27 The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available

against which the deductible temporary differences can be utilised.

29.28 It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity which are expected to reverse:

- (a) in the same period as the expected reversal of the deductible temporary difference; or
- (b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

29.29 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

- (a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). In evaluating whether it will have sufficient taxable profit in future periods, an entity ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or
- (b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

29.30 Tax planning opportunities are actions that the entity would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carryforward. For example, in some jurisdictions, taxable profit may be created or increased by:

- (a) electing to have interest income taxed on either a received or receivable basis;
- (b) deferring the claim for certain deductions from taxable profit;
- (c) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and
- (d) selling an asset that generates non-taxable income (such as, in some jurisdictions, a government bond) in order to purchase another investment that generates taxable income. Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carryforward still depends on the existence of future taxable profit from sources other than future originating temporary differences.

29.31 When an entity has a history of recent losses, the entity considers the guidance in paragraphs 29.35 and 29.36.

29.32 [Deleted]

Goodwill

29.32A If the carrying amount of goodwill arising in a business combination is less than its tax base, the difference gives rise to a deferred tax asset. The deferred tax asset arising from the initial recognition of goodwill shall be recognised as part of the accounting for a business combination to the extent that it is probable that taxable profit will be available

against which the deductible temporary difference could be utilised.

Initial recognition of an asset or liability

29.33 One case when a deferred tax asset arises on initial recognition of an asset is when government grants are set up as deferred income in which case the difference between the deferred income and its tax base of nil is a deductible temporary difference. The entity does not recognise the resulting deferred tax asset, for the reason given in paragraph 29.22.

Unused tax losses and unused tax credits

29.34 A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

29.35 The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity. In such circumstances, paragraph 29.82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

29.36 An entity considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

- (a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;
- (b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;
- (c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and
- (d) whether tax planning opportunities (see paragraph 29.30) are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

Reassessment of unrecognised deferred tax assets

29.37 At the end of each reporting period, an entity reassesses unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it more probable that the entity will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraph 29.24 or 29.34. Another example is when an entity reassesses deferred tax

assets at the date of a business combination or subsequently (see paragraphs 29.67 and 29.68).

Investments in subsidiaries, branches and associates and interests in joint ventures

29.38 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

- (a) the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;
- (b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and
- (c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.

In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount.

29.39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

- (a) the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

29.40 As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

29.41 The non-monetary assets and liabilities of an entity are measured in its functional currency (see Section 30 *Foreign Currency Translation*). If the entity's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in a different currency, changes in the exchange rate give rise to temporary differences that result in a recognised deferred tax liability or (subject to paragraph 29.24) asset. The resulting deferred tax is charged or credited to profit or loss (see paragraph 29.58).

29.42 An investor in an associate does not control that entity and is usually not in a position to determine its dividend policy. Therefore, in the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor recognises a deferred tax liability arising from taxable temporary differences associated with its investment in the associate. In some cases, an investor may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount. In such cases, the deferred tax liability is measured at this amount.

29.43 The arrangement between the parties to a joint venture usually deals with the sharing of the profits and identifies whether decisions on such matters require the consent of all the venturers or a specified majority of the venturers. When the venturer can control the sharing of profits and it is probable that the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

29.44 An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures, to the extent that, and only to the extent that, it is probable that:

(a) the temporary difference will reverse in the foreseeable future; and

(b) taxable profit will be available against which the temporary difference can be utilised.

29.45 In deciding whether a deferred tax asset is recognised for deductible temporary differences associated with its investments in subsidiaries, branches and associates, and its interests in joint ventures, an entity considers the guidance set out in paragraphs 29.28 to 29.31.

Measurement

29.46 Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

29.47 Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

29.48 Current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).

29.49 When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse.

29.50 [not used]

29.51 The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

29.52 In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Example A

An asset has a carrying amount of 100 and a tax base of 60. A tax rate of 20% would apply if the asset were sold and a tax rate of 30% would apply to other income.

The entity recognises a deferred tax liability of 8 (40 at 20%) if it expects to sell the asset without further use and a deferred tax liability of 12 (40 at 30%) if it expects to retain the asset and recover its carrying amount through use.

Example B

An asset with a cost of 100 and a carrying amount of 80 is revalued to 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is 30 and the tax rate is 30%. If the asset is sold for more than cost, the cumulative tax depreciation of 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

The tax base of the asset is 70 and there is a taxable temporary difference of 80. If the entity expects to recover the carrying amount by using the asset, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, there is a deferred tax liability of 24 (80 at 30%). If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of 150, the deferred tax liability is computed as follows:

Taxable	Temporary Difference	Tax Rate	Deferred Tax Liability
Cumulative tax depreciation	30	30%	9
Proceeds in excess of cost	50	nil	—
Total	80		9

(note: in accordance with paragraph 29.61A, the additional deferred tax that arises on the revaluation is recognised in other comprehensive income)

Example C

The facts are as in example B, except that if the asset is sold for more than cost, the cumulative tax depreciation will be included in taxable income (taxed at 30%) and the sale proceeds will be taxed at 40%, after deducting an inflation-adjusted cost of 110.

If the entity expects to recover the carrying amount by using the asset, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, the tax base is 70, there is a taxable temporary difference of 80 and there is a deferred tax liability of 24 (80 at 30%), as in example B.

If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of 150, the entity will be able to deduct the indexed cost of 110. The net proceeds of 40 will be taxed at 40%. In addition, the cumulative tax depreciation of 30 will be included in taxable income and taxed at 30%. On this basis, the tax base is 80 (110 less 30), there is a taxable temporary difference of 70 and there is a deferred tax liability of 25 (40 at 40% plus 30 at 30%). If the tax base is not immediately apparent in this example, it may be helpful to consider the fundamental principle set out in paragraph 10. (note: in accordance with paragraph 29.61A, the additional deferred tax that arises on the revaluation is recognised in other comprehensive income)

29.52A In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of

the entity. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.

29.52B In the circumstances described in paragraph 29.52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in profit or loss for the period as required by paragraph 29.58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 29.58(a) and (b).

Example illustrating paragraphs 29.52A and 29.52B

The following example deals with the measurement of current and deferred tax assets and liabilities for an entity in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%. At the end of the reporting period, 31 December 20X1, the entity does not recognise a liability for dividends proposed or declared after the reporting period. As a result, no dividends are recognised in the year 20X1. Taxable income for 20X1 is 100,000. The net taxable temporary difference for the year 20X1 is 40,000.

The entity recognises a current tax liability and a current income tax expense of 50,000.

No asset is recognised for the amount potentially recoverable as a result of future dividends.

The entity also recognises a deferred tax liability and deferred tax expense of 20,000 (40,000 at 50%) representing the income taxes that the entity will pay when it recovers or settles the carrying amounts of its assets and liabilities based on the tax rate applicable to undistributed profits.

Subsequently, on 15 March 20X2 the entity recognises dividends of 10,000 from previous operating profits as a liability.

On 15 March 20X2, the entity recognises the recovery of income taxes of 1,500 (15% of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.

29.53 Deferred tax assets and liabilities shall not be discounted.

29.54 The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between entities. Therefore, this FRS does not require or permit the discounting of deferred tax assets and liabilities.

29.55 Temporary differences are determined by reference to the carrying amount of an asset or liability. This applies even where that carrying amount is itself determined on a discounted basis, for example in the case of retirement benefit obligations (see Section 28 *Employee Benefits*).

29.56 The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period. An entity shall reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Recognition of current and deferred tax

29.57 Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself. Paragraphs 29.58 to 29.68C implement this principle.

Items recognised in profit or loss

29.58 Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from:

- (a) a transaction or event which is recognised, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity (see paragraphs 29.61A to 29.65); or
- (b) a business combination (see paragraphs 29.66 to 29.68).

29.59 Most deferred tax liabilities and deferred tax assets arise where income or expense is included in accounting profit in one period, but is included in taxable profit (tax loss) in a different period. The resulting deferred tax is recognised in profit or loss. Examples are when interest, royalty or dividend revenue is received in arrears and is included in accounting profit on a time apportionment basis in accordance with Section 23 *Revenue*, but is included in taxable profit (tax loss) on a cash basis.

29.60 The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences. This can result, for example, from:

- (a) a change in tax rates or tax laws;
- (b) a reassessment of the recoverability of deferred tax assets; or

(c) a change in the expected manner of recovery of an asset.

The resulting deferred tax is recognised in profit or loss, except to the extent that it relates to items previously recognised outside profit or loss (see paragraph 29.63).

Items recognised outside profit or loss

29.61 [not used]

29.61A Current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:

(a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 29.62).

(b) directly in equity, shall be recognised directly in equity (see paragraph 29.62A).

29.62 This FRS requires or permits particular items to be recognised in other comprehensive income. An example of such an item is exchange differences arising on the translation of the financial statements of a foreign operation (see Section 30).

29.62A This FRS requires or permits particular items to be credited or charged directly to equity. Examples of such items are:

(a) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error (see Section 10 *Accounting Policies, Estimates and Errors*); and

- (b) amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 29.23).

29.63 In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items recognised outside profit or loss (either in other comprehensive income or directly in equity). This may be the case, for example, when:

- (a) there are graduated rates of income tax and it is impossible to determine the rate at which a specific component of taxable profit (tax loss) has been taxed;
- (b) a change in the tax rate or other tax rules affects a deferred tax asset or liability relating (in whole or in part) to an item that was previously recognised outside profit or loss; or
- (c) an entity determines that a deferred tax asset should be recognised, or should no longer be recognised in full, and the deferred tax asset relates (in whole or in part) to an item that was previously recognised outside profit or loss. In such cases, the current and deferred tax related to items that are recognised outside profit or loss are based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

29.64 [not used].

29.65 When an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of both the asset revaluation and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur. However, if the revaluation for tax purposes is not related to an accounting revaluation of an earlier period, or to one

that is expected to be carried out in a future period, the tax effects of the adjustment of the tax base are recognised in profit or loss.

29.65A When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.

Deferred tax arising from a business combination

29.66 As explained in paragraphs 29.19 and 29.26(c), temporary differences may arise in a business combination. In accordance with Section 19, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 29.24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with paragraph 29.15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

29.67 As a result of a business combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it might no longer be probable that future taxable profit will allow the deferred tax asset to be recovered. In such cases, the acquirer recognises a change in the deferred tax asset in the period of the business combination, but does not include it as part of the accounting for the business combination. Therefore, the acquirer does not take it into

account in measuring the goodwill or bargain purchase gain it recognises in the business combination.

29.68 The potential benefit of the acquiree's income tax loss carryforwards or other deferred tax assets might not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently. An entity shall recognise acquired deferred tax benefits that it realises after the business combination as follows:

- (a) Acquired deferred tax benefits recognised within the measurement period that result from new information shall be applied to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill is zero, any remaining deferred tax benefits shall be recognised in profit or loss.
- (b) All other acquired deferred tax benefits realised shall be recognised in profit or loss (or, if this Section so requires, outside profit or loss).

Current and deferred tax arising from share-based payment transactions

29.68A In some tax jurisdictions, an entity receives a tax deduction (ie an amount that is deductible in determining taxable profit) that relates to remuneration paid in shares, share options or other equity instruments of the entity. The amount of that tax deduction may differ from the related cumulative remuneration expense, and may arise in a later accounting period. For example, in some jurisdictions, an entity may recognise an expense for the consumption of employee services received as consideration for share options granted, in accordance with Section 26 *Share-based Payment*, and not receive a tax deduction until the share options are exercised, with the measurement of the tax deduction based on the entity's share price at the date of exercise.

29.68B As with the research costs discussed in paragraphs 29.9 and 29.26(b) of this Section, the difference between the tax base of the employee services received to date (being the amount the taxation authorities will permit as a deduction in future periods), and the carrying amount of nil, is a deductible temporary difference that results in a deferred tax asset. If the amount the taxation authorities will permit as a deduction in future periods is not known at the end of the period, it shall be estimated, based on information available at the end of the period. For example, if the amount that the taxation authorities will permit as a deduction in future periods is dependent upon the entity's share price at a future date, the measurement of the deductible temporary difference should be based on the entity's share price at the end of the period.

29.68C As noted in paragraph 29.68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 29.68B) may differ from the related cumulative remuneration expense. Paragraph 29.58 of this Section requires that current and deferred tax should be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from (a) a transaction or event that is recognised, in the same or a different period, outside profit or loss, or (b) a business combination. If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity.

Presentation

Tax assets and tax liabilities

29.69 [not used]

29.70 [not used]

Offset

- 29.71 An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:
- (a) has a legally enforceable right to set off the recognised amounts; and
 - (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.
- 29.72 Although current tax assets and liabilities are separately recognised and measured they are offset in the statement of financial position subject to the above criteria. An entity will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment.
- 29.73 In consolidated financial statements, a current tax asset of one entity in a group is offset against a current tax liability of another entity in the group if, and only if, the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.
- 29.74 An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:
- (a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
 - (b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
 - (i) the same taxable entity; or

- (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

29.75 To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this FRS requires an entity to set off a deferred tax asset against a deferred tax liability of the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off current tax assets against current tax liabilities.

29.76 In rare circumstances, an entity may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

Tax expense

Tax expense (income) related to profit or loss from ordinary activities

29.77 The tax expense (income) related to profit or loss from ordinary activities shall be presented in the statement of comprehensive income.

29.77A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 5.2, it presents the tax expense (income) related to profit or loss from ordinary activities in that separate statement.

Exchange differences on deferred foreign tax liabilities or assets

29.78 Section 30 requires certain exchange differences to be recognised in profit or loss but does not specify where such differences should be presented in the statement of comprehensive income. Accordingly, where exchange differences on deferred foreign tax liabilities or assets are recognised in the statement of comprehensive income, such differences may be classified as deferred tax expense (income) if that presentation is considered to be the most useful to financial statement users.

Disclosure

29.79 The major components of tax expense (income) shall be disclosed separately.

29.80 Components of tax expense (income) may include:

- (a) current tax expense (income);
- (b) any adjustments recognised in the period for current tax of prior periods;
- (c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;
- (d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
- (e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
- (f) the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary

difference of a prior period that is used to reduce deferred tax expense;

- (g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56; and
- (h) the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with Section 10, because they cannot be accounted for retrospectively.

29.81 The following shall also be disclosed separately:

- (a) the aggregate current and deferred tax relating to items that are charged or credited directly to equity (see paragraph 29.62A);
- (ab) the amount of income tax relating to each component of other comprehensive income (see paragraph 29.62 and Section 5);
- (b) [deleted];
- (c) an explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:
 - (i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or
 - (ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;

- (d) an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;
- (e) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the statement of financial position;
- (f) the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognised (see paragraph 29.39);
- (g) in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:
 - (i) the amount of the deferred tax assets and liabilities recognised in the statement of financial position for each period presented;
 - (ii) the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the statement of financial position;
- (h) in respect of discontinued operations, the tax expense relating to:
 - (i) the gain or loss on discontinuance; and
 - (ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented;
- (i) the amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were

authorised for issue, but are not recognised as a liability in the financial statements;

(j) if a business combination in which the entity is the acquirer causes a change in the amount recognised for its pre-acquisition deferred tax asset (see paragraph 29.67), the amount of that change; and

(k) if the deferred tax benefits acquired in a business combination are not recognised at the acquisition date but are recognised after the acquisition date (see paragraph 29.68), a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.

29.82 An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

(a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

(b) the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

29.82A In the circumstances described in paragraph 29.52A, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.

29.83 [not used]

- 29.84 The disclosures required by paragraph 29.81(c) enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. The relationship between tax expense (income) and accounting profit may be affected by such factors as revenue that is exempt from taxation, expenses that are not deductible in determining taxable profit (tax loss), the effect of tax losses and the effect of foreign tax rates.
- 29.85 In explaining the relationship between tax expense (income) and accounting profit, an entity uses an applicable tax rate that provides the most meaningful information to the users of its financial statements. Often, the most meaningful rate is the domestic rate of tax in the country in which the entity is domiciled, aggregating the tax rate applied for national taxes with the rates applied for any local taxes which are computed on a substantially similar level of taxable profit (tax loss). However, for an entity operating in several jurisdictions, it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction. The following example illustrates how the selection of the applicable tax rate affects the presentation of the numerical reconciliation.

Example illustrating paragraph 29.85

In 19X2, an entity has accounting profit in its own jurisdiction (country A) of 1,500 (19X1: 2,000) and in country B of 1,500 (19X1: 500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of 100 (19X1: 200) are not deductible for tax purposes.

The following is an example of a reconciliation to the domestic tax rate.

	19X1	19X2
Accounting profit	2,500	3,000
Tax at the domestic rate of 30%	750	900
Tax effect of expenses that are not deductible for tax purposes	60	30
Effect of lower tax rates in country B	(50)	(150)
Tax expense	760	780

The following is an example of a reconciliation prepared by aggregating separate reconciliations for each national jurisdiction. Under this method, the effect of differences between the reporting entity's own domestic tax rate and the domestic tax rate in other jurisdictions does not appear as a separate item in the reconciliation.

An entity may need to discuss the effect of significant changes in either tax rates, or the mix of profits earned in different jurisdictions, in order to explain changes in the applicable tax rate(s), as required by paragraph 29.81(d).

Accounting profit	2,500	3,000
Tax at the domestic rates applicable to profits in the country concerned	700	750
Tax effect of expenses that are not deductible for tax purposes	60	30
Tax expense	760	780

29.86 The average effective tax rate is the tax expense (income) divided by the accounting profit.

29.87 It would often be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches and associates and interests in joint ventures (see paragraph 29.39). Therefore, this FRS requires an entity to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, entities are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.

29.87A Paragraph 29.82A requires an entity to disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. An entity discloses the important features of the income tax systems and the factors that will affect the amount of the potential income tax consequences of dividends.

29.87B It would sometimes not be practicable to compute the total amount of the potential income tax consequences that would result from the payment of dividends to shareholders. This may be the case, for example, where an entity has a large number of foreign subsidiaries. However, even in such circumstances, some portions of the total amount may be easily determinable. For example, in a consolidated group, a parent and some of its subsidiaries may have paid income taxes at a higher rate on undistributed profits and be aware of the amount that would be refunded on the payment of future dividends to shareholders from consolidated retained earnings. In this case, that refundable amount is disclosed. If applicable, the entity also discloses that there are additional potential income tax consequences not practicably determinable. In the parent's separate financial statements, if any, the disclosure of the potential income tax consequences relates to the parent's retained earnings.

29.87C An entity required to provide the disclosures in paragraph 29.82A may also be required to provide disclosures related

to temporary differences associated with investments in subsidiaries, branches and associates or interests in joint ventures. In such cases, an entity considers this in determining the information to be disclosed under paragraph 29.82A. For example, an entity may be required to disclose the aggregate amount of temporary differences associated with investments in subsidiaries for which no deferred tax liabilities have been recognised (see paragraph 29.81(f)). If it is impracticable to compute the amounts of unrecognised deferred tax liabilities (see paragraph 29.87) there may be amounts of potential income tax consequences of dividends not practicably determinable related to these subsidiaries.

29.88 An entity discloses any tax-related contingent liabilities and contingent assets in accordance with Section 21 *Provisions and Contingencies*. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see Section 32 *Events after the End of the Reporting Period*).

SECTION 30: FOREIGN CURRENCY TRANSLATION

SCOPE OF THIS SECTION

- 30.1 An entity can conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a **presentation currency**. Accounting for **financial instruments** denominated in a foreign currency and hedge accounting of foreign currency items are dealt with in Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*.

FUNCTIONAL CURRENCY

- 30.2 Each entity shall identify its **functional currency**. An entity's functional currency is the currency of the primary economic environment in which the entity operates.
- 30.3 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Therefore, the following are the most important factors an entity considers in determining its functional currency:
- (a) the currency:
 - (i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled), and

- (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
 - (b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).
- 30.4 The following factors may also provide evidence of an entity's functional currency:
- (a) the currency in which funds from financing activities (issuing debt and equity instruments) are generated.
 - (b) the currency in which receipts from operating activities are usually retained.
- 30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):
- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other **monetary items**, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.
 - (b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.

- (c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
- (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

REPORTING FOREIGN CURRENCY TRANSACTIONS IN THE FUNCTIONAL CURRENCY

Initial recognition

- 30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
 - (a) buys or sells goods or services whose price is denominated in a foreign currency;
 - (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
 - (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
- 30.7 An entity shall record a foreign currency transaction, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.
- 30.8 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this FRS. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring

during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at the end of the subsequent reporting periods

- 30.9 At the end of each **reporting period**, an entity shall:
- (a) translate foreign currency monetary items using the closing rate;
 - (b) translate non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction; and
 - (c) translate non-monetary items that are measured at fair value in a foreign currency using the exchange rates at the date when the fair value was determined.
- 30.10 An entity shall recognise, in profit or loss in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous periods, except as described in paragraph 30.13.
- 30.11 When another section of this FRS requires a gain or loss on a non-monetary item to be recognised in other comprehensive income, an entity shall recognise any exchange component of that gain or loss in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, an entity shall recognise any exchange component of that gain or loss in profit or loss.

NET INVESTMENT IN A FOREIGN OPERATION

- 30.12 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the

foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 30.13. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

- 30.13 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reported as a component of equity. They shall not again be recognised in profit or loss on disposal of the net investment.

CHANGE IN FUNCTIONAL CURRENCY

- 30.14 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.
- 30.15 As noted in paragraphs 30.2–30.5, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.
- 30.16 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated

amounts for non-monetary items are treated as their historical cost.

USE OF A PRESENTATION CURRENCY OTHER THAN THE FUNCTIONAL CURRENCY

Translation to the presentation currency

- 30.17 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, the entity shall translate its items of income and expense and **financial position** into the presentation currency. For example, when a **group** contains individual entities with different functional currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.
- 30.18 An entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:
- (a) Assets and liabilities for each statement of financial position presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;
 - (b) Income and expenses for each statement of comprehensive income (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and
 - (c) All resulting exchange differences shall be recognised in other comprehensive income.
- 30.19 For practical reasons, an entity may use a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period,

to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

30.20 The exchange differences referred to in paragraph 30.18(c) result from:

- (a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate, and
- (b) translating the opening net assets at a closing rate that differs from the previous closing rate.

When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to the **non-controlling interest** are allocated to, and recognised as part of, non-controlling interest in the consolidated statement of financial position.

30.21 An entity whose functional currency is the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the procedures specified in Section 31 *Hyperinflation*.

Translation of a foreign operation into the investor's presentation currency

30.22 In incorporating the assets, liabilities, income and expenses of a foreign operation with those of the reporting entity, the entity shall follow normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see Section 9 *Consolidated and Separate Financial Statements*). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the

monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements, a reporting entity continues to recognise such an exchange difference in profit or loss or, if it arises from the circumstances described in paragraph 30.13, the entity shall classify it as equity.

- 30.23 Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the **carrying amounts** of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 30.18.

DISCLOSURES

- 30.24 In paragraphs 30.26 and 30.27, references to ‘functional currency’ apply, in the case of a group, to the functional currency of the parent.
- 30.25 An entity shall disclose the following:
- (a) the amount of exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss in accordance with Sections 11 and 12.
 - (b) the amount of exchange differences arising during the period and classified in a separate component of equity at the end of the period.
- 30.26 An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.

- 30.27 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

SECTION 31 : HYPERINFLATION

SCOPE OF THIS SECTION

- 31.1 This section applies to an entity whose **functional currency** is the currency of a hyperinflationary economy. It requires such an entity to prepare **financial statements** that have been adjusted for the effects of hyperinflation.

HYPERINFLATIONARY ECONOMY

- 31.2 This section does not establish an absolute rate at which an economy is deemed hyperinflationary. An entity shall make that judgement by considering all available information including, but not limited to, the following possible indicators of hyperinflation:
- (a) The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.
 - (b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.
 - (c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.
 - (d) Interest rates, wages and prices are linked to a price index.
 - (e) The cumulative inflation rate over three years is approaching, or exceeds, 100 per cent.

MEASURING UNIT IN THE FINANCIAL STATEMENTS

- 31.3 All amounts in the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the end of the **reporting period**. The comparative information for the previous period required by paragraph 3.14, and any information presented in respect of earlier periods, shall also be stated in terms of the measuring unit current at the **reporting date**.
- 31.4 The restatement of financial statements in accordance with this section requires the use of a general price index that reflects changes in general purchasing power. In most economies there is a recognised general price index, normally produced by the government, that entities will follow.

PROCEDURES FOR RESTATING HISTORICAL COST FINANCIAL STATEMENTS

Statement of financial position

- 31.5 Statement of financial position amounts not expressed in terms of the measuring unit current at the end of the reporting period are restated by applying a general price index.
- 31.6 Monetary items are not restated because they are expressed in terms of the measuring unit current at the end of the reporting period. Monetary items are money held and items to be received or paid in money.
- 31.7 Assets and liabilities linked by agreement to changes in prices, such as index-linked bonds and loans, are adjusted in accordance with the agreement and presented at this adjusted amount in the restated statement of financial position.

- 31.8 All other assets and liabilities are non-monetary:
- (a) Some non-monetary items are carried at amounts current at the end of the reporting period, such as net realisable value and fair value, so they are not restated. All other non-monetary assets and liabilities are restated.
 - (b) Most non-monetary items are carried at cost or cost less depreciation; hence they are expressed at amounts current at their date of acquisition. The restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the end of the reporting period.
 - (c) The restated amount of a non-monetary item is reduced, in accordance with Section 27 *Impairment of Assets*, when it exceeds its **recoverable amount**.
- 31.9 At the beginning of the first period of application of this section, the components of **equity**, except retained earnings, are restated by applying a general price index from the dates the components were contributed or otherwise arose. Restated retained earnings are derived from all the other amounts in the restated statement of financial position.
- 31.10 At the end of the first period and in subsequent periods, all components of owners' equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The changes for the period in owners' equity are disclosed in accordance with Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*.

Statement of comprehensive income and income statement

- 31.11 All items in the statement of comprehensive income (and in the income statement, if presented) shall be expressed in terms of the measuring unit current at the end of the reporting period. Therefore, all amounts need to be restated by applying the change in the general price index from the dates when the items of income and expenses were initially recognised in the financial statements. If general inflation is approximately even throughout the period, and the items of income and expense arose approximately evenly throughout the period, an average rate of inflation may be appropriate.

Statement of cash flows

- 31.12 An entity shall express all items in the **statement of cash flows** in terms of the measuring unit current at the end of the reporting period.

Gain or loss on net monetary position

- 31.13 In a period of inflation, an entity holding an excess of monetary assets over monetary liabilities loses purchasing power, and an entity with an excess of monetary liabilities over monetary assets gains purchasing power, to the extent the assets and liabilities are not linked to a price level. An entity shall include in profit or loss the gain or loss on the net monetary position. An entity shall offset the adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 31.7 against the gain or loss on net monetary position.

Economies ceasing to be hyperinflationary

- 31.14 When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this section, it shall treat the amounts expressed in the presentation currency at the end of the previous reporting

period as the basis for the **carrying amounts** in its subsequent financial statements.

DISCLOSURES

- 31.15 An entity to which this section applies shall disclose the following:
- (a) the fact that financial statements and other prior period data have been restated for changes in the general purchasing power of the functional currency.
 - (b) the identity and level of the price index at the reporting date and changes during the current reporting period and the previous reporting period.
 - (c) amount of gain or loss on monetary items.

SECTION 32: EVENTS AFTER THE END OF THE REPORTING PERIOD

SCOPE OF THIS SECTION

- 32.1 This section defines events after the end of the **reporting period** and sets out principles for recognising, measuring and disclosing those events.

EVENTS AFTER THE END OF THE REPORTING PERIOD DEFINED

- 32.2 Events after the end of the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. There are two types of events:
- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period), and
 - (b) those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period).
- 32.3 Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of profit or loss of other selected financial information.

RECOGNITION AND MEASUREMENT

Adjusting events after the end of the reporting period

- 32.4 An entity shall adjust the amounts recognised in its financial statements, including related disclosures, to reflect adjusting events after the end of the reporting period.

- 32.5 The following are examples of adjusting events after the end of the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:
- (a) the settlement after the end of the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised **provision** related to this court case in accordance with Section 21 *Provisions and Contingencies* or recognises a new provision. The entity does not merely disclose a contingent liability. Rather, the settlement provides additional evidence to be considered in determining the provision that should be recognised at the end of the reporting period in accordance with Section 21.
 - (b) the receipt of information after the end of the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:
 - (i) the bankruptcy of a customer that occurs after the end of the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the entity needs to adjust the **carrying amount** of the trade receivable; and
 - (ii) the sale of inventories after the end of the reporting period may give evidence about their selling price at the end of the reporting period for the purpose of assessing impairment at that date.
 - (c) the determination after the end of the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

- (d) the determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the entity had a legal or **constructive obligation** at the end of the reporting period to make such payments as a result of events before that date (see Section 28 *Employee Benefits*).
- (e) the discovery of fraud or **errors** that show that the financial statements are incorrect.

Non-adjusting events after the end of the reporting period

- 32.6 An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.
- 32.7 Examples of non-adjusting events after the end of the reporting period include:
- (a) a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure in accordance with paragraph 32.10.
 - (b) an amount that becomes receivable as a result of a favourable judgement or settlement of a court case after the **reporting date** but before the financial statements are issued. This would be a contingent asset at the reporting date (see paragraph 21.13), and disclosure may be required by paragraph 21.16. However, agreement on the amount of damages for a

judgement that was reached before the reporting date, but was not previously recognised because the amount could not be measured reliably, may constitute an adjusting event.

Dividends

- 32.8 If an entity declares dividends to holders of its equity instruments after the end of the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period. The amount of the dividend may be presented as a segregated component of retained earnings at the end of the reporting period.

DISCLOSURE

Date of authorisation for issue

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

Non-adjusting events after the end of the reporting period

- 32.10 An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period:
- (a) the nature of the event, and
 - (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

- 32.11 The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure; the disclosures will reflect information that becomes known after the end of the reporting period but before the financial statements are authorised for issue:
- (a) a major business combination or disposal of a major subsidiary.
 - (b) announcement of a plan to discontinue an operation.
 - (c) major purchases of assets, disposals or plans to dispose of assets, or expropriation of major assets by government.
 - (d) the destruction of a major production plant by a fire.
 - (e) announcement, or commencement of the implementation, of a major restructuring.
 - (f) issues or repurchases of an entity's debt or equity instruments.
 - (g) abnormally large changes in asset prices or foreign exchange rates.
 - (h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities.
 - (i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees.
 - (j) commencement of major litigation arising solely out of events that occurred after the end of the reporting period.

SECTION 33: RELATED PARTY DISCLOSURES

SCOPE OF THIS SECTION

- 33.1 This section requires an entity to include in its financial statements the disclosures necessary to draw attention to the possibility that its **financial position** and profit or loss have been affected by the existence of **related parties** and by transactions and outstanding balances with such parties.

RELATED PARTY DEFINED

- 33.2 A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).
- (a) A person or a close member of that person's family is related to a reporting entity if that person:
 - (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity;
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity; or
 - (b) An entity is related to a reporting entity if any of the following conditions applies:
 - (i) the entity and the reporting entity are members of the same **group** (which means that each parent, subsidiary and fellow subsidiary is related to the others).

- (ii) one entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member).
- (iii) both entities are joint ventures of the same third party.
- (iv) either entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) the entity is controlled or jointly controlled by a person identified in (a).
- (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

[Remaining text is deleted]

- 33.3 In considering each possible related party relationship, an entity shall assess the substance of the relationship and not merely the legal form.
- 33.4 In the context of this FRS, the following are not necessarily related parties:
- (a) two entities simply because they have a director or other member of key management personnel in common.
 - (b) two **venturers** simply because they share **joint control** over a joint venture.

- (c) any of the following simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process):
 - (i) providers of finance.
 - (ii) trade unions.
 - (iii) public utilities.
 - (iv) government departments and agencies.
- (d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, merely by virtue of the resulting economic dependence.

DISCLOSURES

Disclosure of parent–subsidiary relationships

- 33.5 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been related party transactions. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity’s parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

- 33.6 Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Compensation includes all employee benefits (as defined in Section 28 *Employee Benefits*) including those in the form of share-based payment (see Section 26 *Share-based*

Payment). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (eg by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of goods or services provided to the entity.

- 33.7 An entity shall disclose key management personnel compensation in total.

Disclosure of related party transactions

- 33.8 A **related party transaction** is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged. Examples of related party transactions that are common to entities within the scope of this FRS include, but are not limited to:

- (a) transactions between an entity and its principal owner(s).
- (b) transactions between an entity and another entity when both entities are under the common control of a single entity or person.
- (c) transactions in which an entity or person that controls the reporting entity incurs expenses directly that otherwise would have been borne by the reporting entity.

- 33.9 If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall include:

- (a) the amount of the transactions.
- (b) the amount of outstanding balances and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement, and
 - (ii) details of any guarantees given or received.
- (c) provisions for uncollectible receivables related to the amount of outstanding balances.
- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Such transactions could include purchases, sales, or transfers of goods or services; leases; guarantees; and settlements by the entity on behalf of the related party or vice versa.

- 33.10 An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories:
- (a) entities with control, joint control or significant influence over the entity.
 - (b) entities over which the entity has control, joint control or significant influence.
 - (c) key management personnel of the entity or its parent (in the aggregate).
 - (d) other related parties.
- 33.11 An entity is exempt from the disclosure requirements of paragraph 33.9 in relation to:

- (a) a **state** (a national, regional or local government) that has control, joint control or significant influence over the reporting entity, and
- (b) another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity.

However, the entity must still disclose a parent–subsidiary relationship as required by paragraph 33.5.

33.12 The following are examples of transactions that shall be disclosed if they are with a related party:

- (a) purchases or sales of goods (finished or unfinished).
- (b) purchases or sales of property and other assets.
- (c) rendering or receiving of services.
- (d) leases.
- (e) transfers of research and development.
- (f) transfers under licence agreements.
- (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind).
- (h) provision of guarantees or collateral.
- (i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.
- (j) participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities.

33.13 An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm’s length transactions unless such terms can be substantiated.

- 33.14 An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

SECTION 34: SPECIALISED ACTIVITIES

SCOPE OF THIS SECTION

- 34.1 This section provides guidance on financial reporting by entities within the scope of this FRS involved in three types of specialised activities—agriculture, extractive activities, and service concessions.

AGRICULTURE

- 34.2 An entity using this FRS that is engaged in **agricultural activity** shall determine its accounting policy for each class of its **biological assets** as follows:
- (a) The entity shall use the fair value model in paragraphs 34.4–34.7 for those biological assets for which **fair value** is readily determinable without undue cost or effort.
 - (b) The entity shall use the cost model in paragraphs 34.8–34.10 for all other biological assets.

Recognition

- 34.3 An entity shall recognise a biological asset or **agricultural produce** when, and only when:
- (a) the entity controls the asset as a result of past events;
 - (b) it is probable that future economic benefits associated with the asset will flow to the entity; and
 - (c) the fair value or cost of the asset can be measured reliably without undue cost or effort.

Measurement – fair value model

- 34.4 An entity shall measure a biological asset on initial recognition and at each **reporting date** at its fair value less costs to sell. Changes in fair value less costs to sell shall be recognised in profit or loss.
- 34.5 Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 *Inventories* or another applicable section of this FRS.
- 34.6 In determining fair value, an entity shall consider the following:
- (a) If an active market exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an entity has access to different active markets, the entity shall use the price existing in the market that it expects to use.
 - (b) If an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:
 - (i) the most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the end of the reporting period;
 - (ii) market prices for similar assets with adjustment to reflect differences; and
 - (iii) sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.

- (c) In some cases, the information sources listed in (a) or (b) may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.
- (d) In some circumstances, fair value may be readily determinable without undue cost or effort even though market determined prices or values are not available for a biological asset in its present condition. An entity shall consider whether the present value of expected net cash flows from the asset discounted at a current market determined rate results in a reliable measure of fair value.

Disclosures – fair value model

- 34.7 An entity shall disclose the following with respect to its biological assets measured at fair value:
- (a) a description of each class of its biological assets.
 - (b) the methods and significant assumptions applied in determining the fair value of each category of agricultural produce at the point of harvest and each category of biological assets.
 - (c) a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:
 - (i) the gain or loss arising from changes in fair value less costs to sell.
 - (ii) increases resulting from purchases.
 - (iii) decreases resulting from harvest.
 - (iv) increases resulting from business combinations.

- (v) net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity.
- (vi) other changes.

Measurement – cost model

- 34.8 The entity shall measure at cost less any accumulated **depreciation** and any accumulated **impairment** losses those biological assets whose fair value is not readily determinable without undue cost or effort.
- 34.9 The entity shall measure agricultural produce harvested from its biological assets at fair value less estimated costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 or other sections of this FRS.

Disclosures – cost model

- 34.10 An entity shall disclose the following with respect to its biological assets measured using the cost model:
- (a) a description of each class of its biological assets.
 - (b) an explanation of why fair value cannot be measured reliably.
 - (c) the depreciation method used.
 - (d) the useful lives or the depreciation rates used.
 - (e) the gross **carrying amount** and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

EXTRACTIVE ACTIVITIES

- 34.11 An entity using this FRS that is engaged in the exploration for, evaluation or extraction of mineral resources (extractive activities) shall account for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities by applying Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, respectively. When an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.

SERVICE CONCESSION ARRANGEMENTS

- 34.12 A service concession arrangement is an arrangement whereby a government or other public sector body (the grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. In those arrangements, the grantor controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.
- 34.13 There are two principal categories of service concession arrangements:
- (a) In one, the operator receives a financial asset—an unconditional contractual right to receive a specified or determinable amount of cash or another financial asset from the government in return for constructing or upgrading a public sector asset, and then operating and maintaining the asset for a specified period of time. This category includes guarantees by the government to pay for any shortfall between amounts received from users of the public service and specified or determinable amounts.

- (b) In the other, the operator receives an intangible asset—a right to charge for use of a public sector asset that it constructs or upgrades and then operates and maintains for a specified period of time. A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service.

Sometimes, a single contract may contain both types: to the extent that the government has given an unconditional guarantee of payment for the construction of the public sector asset, the operator has a financial asset; to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset.

Accounting – financial asset model

- 34.14 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The operator shall measure the financial asset at fair value. Thereafter, it shall follow Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* in accounting for the financial asset.

Accounting – intangible asset model

- 34.15 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. The operator shall initially measure the intangible asset at fair value. Thereafter, it shall follow Section 18 in accounting for the intangible asset.

Operating revenue

- 34.16 The operator of a service concession arrangement shall recognise, measure and disclose revenue in accordance with Section 23 *Revenue* for the services it performs.

SECTION 35: TRANSITION TO THE FRSME

SCOPE OF THIS SECTION

- 35.1 This section applies to a **first-time adopter of the FRSME**, regardless of whether its previous accounting framework was **full IFRSs** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards, or another framework such as the local income tax basis.
- 35.2 An entity can be a first-time adopter of the FRSME only once. If an entity using the FRSME stops using it for one or more **reporting periods** and then is required, or chooses, to adopt it again later, the special exemptions, simplifications and other requirements in this section do not apply to the re-adoption.

FIRST-TIME ADOPTION

- 35.3 A first-time adopter of the FRSME shall apply this section in its first **financial statements** that conform to this FRS.
- 35.4 An entity's first financial statements that conform to this FRS are the first annual financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with the FRSME. Financial statements prepared in accordance with this FRS are an entity's first such financial statements if, for example, the entity:
- (a) did not present financial statements for previous periods;
 - (b) presented its most recent previous financial statements under national requirements that are not consistent with this FRS in all respects; or

- (c) presented its most recent previous financial statements in conformity with full IFRSs.
- 35.5 Paragraph 3.17 of this FRS defines a complete set of financial statements.
- 35.6 Paragraph 3.14 requires an entity to disclose, in a complete set of financial statements, comparative information in respect of the previous comparable period for all monetary amounts presented in the financial statements, as well as specified comparative narrative and descriptive information. An entity may present comparative information in respect of more than one comparable prior period. Therefore, an entity's **date of transition to the FRSME** is the beginning of the earliest period for which the entity presents full comparative information in accordance with this FRS in its first financial statements that conform to this FRS.

PROCEDURES FOR PREPARING FINANCIAL STATEMENTS AT THE DATE OF TRANSITION

- 35.7 Except as provided in paragraphs 35.9–35.11, an entity shall, in its opening statement of financial position as of its date of transition to the FRSME (ie the beginning of the earliest period presented):
- (a) recognise all assets and liabilities whose recognition is required by the FRSME;
 - (b) not recognise items as assets or liabilities if this FRS does not permit such recognition;
 - (c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under this FRS; and
 - (d) apply this FRS in measuring all recognised assets and liabilities.

- 35.8 The **accounting policies** that an entity uses in its opening statement of financial position under this FRS may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this FRS. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this FRS.
- 35.9 On first-time adoption of this FRS, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:
- (a) **derecognition** of financial assets and financial liabilities. Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition should not be recognised upon adoption of the FRSME. Conversely, for financial assets and liabilities that would have been derecognised under the FRSME in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose (a) to derecognise them on adoption of the FRSME or (b) to continue to recognise them until disposed of or settled.
 - (b) hedge accounting. An entity shall not change its hedge accounting before the date of transition to the FRSME for the hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Section 12 *Other Financial Instruments Issues*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Section 12.
 - (c) accounting estimates.

- (d) **discontinued operations.**
 - (e) measuring **non-controlling interests.** The requirements of paragraph 5.6 to allocate profit or loss and total comprehensive income between non-controlling interest and **owners** of the parent shall be applied prospectively from the date of transition to the FRSME (or from such earlier date as this FRS is applied to restate business combinations—see paragraph 35.10).
- 35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this FRS:
- (a) ***Business combinations.*** A first-time adopter may elect not to apply Section 19 *Business Combinations and Goodwill* to business combinations that were effected before the date of transition to this FRS. However, if a first-time adopter restates any business combination to comply with Section 19, it shall restate all later business combinations.
 - (b) ***Share-based payment transactions.*** A first-time adopter is not required to apply Section 26 *Share-based Payment* to equity instruments that were granted before the date of transition to this FRS, or to liabilities arising from share-based payment transactions that were settled before the date of transition to this FRS.
 - (c) ***Fair value as deemed cost.*** A first-time adopter may elect to measure an item of property, plant and equipment, an investment property, or an intangible asset on the date of transition to this FRS at its fair value and use that fair value as its deemed cost at that date.
 - (d) ***Revaluation as deemed cost.*** A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment, an investment

property, or an intangible asset at, or before, the date of transition to this FRS as its deemed cost at the revaluation date.

- (e) **Cumulative translation differences.** Section 30 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity. A first-time adopter may elect to deem the cumulative translation differences for all foreign operations to be zero at the date of transition to the FRSME (ie a 'fresh start').
- (f) **Separate financial statements.** When an entity prepares **separate financial statements**, paragraph 9.26 requires it to account for its investments in subsidiaries, associates, and jointly controlled entities either:
 - (i) at cost less impairment, or
 - (ii) at **fair value** with changes in fair value recognised in profit or loss.

If a first-time adopter measures such an investment at cost, it shall measure that investment at one of the following amounts in its separate opening statement of financial position prepared in accordance with this FRS:

- (i) cost determined in accordance with Section 9 *Consolidated and Separate Financial Statements*, or
 - (ii) deemed cost, which shall be either fair value at the date of transition to the FRSME or previous GAAP carrying amount on that date.
- (g) **Compound financial instruments.** Paragraph 22.13 requires an entity to split a compound financial instrument into its liability and equity components at the date of issue. A first-time adopter need not separate

those two components if the liability component is not outstanding at the date of transition to this FRS.

- (h) ***Deferred income tax.*** A first-time adopter is not required to recognise, at the date of transition to the FRSME, **deferred tax assets** or **deferred tax liabilities** relating to differences between the **tax basis** and the **carrying amount** of any assets or liabilities for which recognition of those deferred tax assets or liabilities would involve undue cost or effort.
- (i) ***Service concession arrangements.*** A first-time adopter is not required to apply paragraphs 34.12–34.16 to service concession arrangements entered into before the date of transition to this FRS.
- (j) ***Extractive activities.*** A first-time adopter using full cost accounting under previous GAAP may elect to measure oil and gas assets (those used in the exploration, evaluation, development or production of oil and gas) on the date of transition to the FRSME at the amount determined under the entity's previous GAAP. The entity shall test those assets for impairment at the date of transition to this FRS in accordance with Section 27 *Impairment of Assets*.
- (k) ***Arrangements containing a lease.*** A first-time adopter may elect to determine whether an arrangement existing at the date of transition to the FRSME contains a lease (see paragraph 20.3) on the basis of facts and circumstances existing at that date, rather than when the arrangement was entered into.
- (l) ***Decommissioning liabilities included in the cost of property, plant and equipment.*** Paragraph 17.10(c) states that the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a

consequence of having used the item during a particular period for purposes other than to produce inventories during that period. A first-time adopter may elect to measure this component of the cost of an item of property, plant and equipment at the date of transition to the FRSME, rather than on the date(s) when the obligation initially arose.

- (m) ***Dormant companies*** a company within the Companies Act definition of a dormant company may elect to retain its accounting policies for measurement of reported assets, liabilities and equity at the date of transition to this FRS until there is any change to those balances or the company undertakes any new transactions.

- 35.11 If it is **impracticable** for an entity to restate the opening statement of financial position at the date of transition for one or more of the adjustments required by paragraph 35.7, the entity shall apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify the data presented for prior periods that are not comparable with data for the period period in which it prepares its first financial statements that conform to this FRS. If it is impracticable for an entity to provide any disclosures required by this FRS for any period before the period in which it prepares its first financial statements that conform to this FRS, the omission shall be disclosed.

DISCLOSURES

Explanation of transition to the FRSME

- 35.12 An entity shall explain how the transition from its previous financial reporting framework to this FRS affected its reported **financial position**, financial **performance** and **cash flows**.

Reconciliations

- 35.13 To comply with paragraph 35.12, an entity's first financial statements prepared using this FRS shall include:
- (a) a description of the nature of each change in accounting policy.
 - (b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this FRS for both of the following dates:
 - (i) the date of transition to this FRS, and
 - (ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.
 - (c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this FRS for the same period.
- 35.14 If an entity becomes aware of errors made under its previous financial reporting framework, the reconciliations required by paragraph 35.13(b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.
- 35.15 If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this FRS.

GLOSSARY OF TERMS

accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
accrual basis of accounting	The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
accumulating compensated absences	Compensated absences that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
agricultural activity	The management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets.
agricultural produce	The harvested product of the entity's biological assets.
amortisation	The systematic allocation of the depreciable amount of an asset over its useful life.

amortised cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.
asset	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
associate	An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.
biological asset	A living animal or plant.
borrowing costs	Interest and other costs incurred by an entity in connection with the borrowing of funds.
business	An integrated set of activities and assets conducted and managed for the purpose of providing: <ul style="list-style-type: none"> (a) a return to investors, or (b) lower costs or other economic benefits directly and proportionately to policyholders or participants.

	A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.
business combination	The bringing together of separate entities or businesses into one reporting entity.
carrying amount	The amount at which an asset or liability is recognised in the statement of financial position.
cash	Cash on hand and demand deposits.
cash equivalent	Short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.
cash flows	Inflows and outflows of cash and cash equivalents.
cash-generating unit	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
cash-settled share-based payment transaction	A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity.

change in accounting estimate	An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.
class of assets	A grouping of assets of a similar nature and use in an entity's operations.
combined financial statements	The financial statements of two or more entities controlled by a single investor.
component of an entity	Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.
compound financial instrument	A financial instrument that, from the issuer's perspective, contains both a liability and an equity element.
consolidated financial statements	The financial statements of a parent and its subsidiaries presented as those of a single economic entity.
construction contract	A contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

constructive obligation

An obligation that derives from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities, and
- (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

contingent asset

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

contingent liability

- (a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.

control (of an entity)	The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
current tax	The amount of income tax payable (refundable) in respect of the taxable profit (tax loss) for the current period or past reporting periods.
date of transition to the FRSME	The beginning of the earliest period for which an entity presents full comparative information under the FRSME in its first financial statements that comply with the FRSME.
deferred tax	Income tax payable (recoverable) in respect of the taxable profit (tax loss) for future reporting periods as a result of past transactions or events.
deferred tax assets	Income tax recoverable in future reporting periods in respect of: <ul style="list-style-type: none"> (a) deductible temporary differences; (b) the carryforward of unused tax losses; and (c) the carryforward of unused tax credits.
deferred tax liabilities	Income tax payable in future reporting periods in respect of taxable temporary differences.
defined benefit liability	The present value of the defined benefit obligation at the reporting date minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

defined benefit obligation (present value of)	The present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.
defined benefit plans	Post-employment benefit plans other than defined contribution plans.
defined contribution plans	Post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.
depreciable amount	The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value.
depreciation	The systematic allocation of the depreciable amount of an asset over its useful life.
derecognition	The removal of a previously recognised asset or liability from an entity's statement of financial position.
development	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

discontinued operation	<p>A component of an entity that either has been disposed of, or is held for sale, and</p> <ul style="list-style-type: none"> (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to resale.
effective interest method	<p>A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.</p>
effective interest rate	<p>The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.</p>
effectiveness of a hedge	<p>The degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.</p>
employee benefits	<p>All forms of consideration given by an entity in exchange for service rendered by employees.</p>
equity	<p>The residual interest in the assets of the entity after deducting all its liabilities.</p>

equity-settled share-based payment transaction	A share-based payment transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options).
errors	<p>Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:</p> <ul style="list-style-type: none"> <li data-bbox="436 542 963 638">(a) was available when financial statements for those periods were authorised for issue, and <li data-bbox="436 654 963 782">(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
expenses	Decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors.
fair presentation	Faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.
fair value	The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

fair value less costs to sell The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

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

financial asset Any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity, or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and:
 - (i) under which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or
 - (ii) that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed

number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial instrument

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

financial liability

Any liability that is:

- (a) a contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, or
- (b) a contract that will or may be settled in the entity's own equity instruments and:
 - (i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or
 - (ii) will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity

instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial position	The relationship of the assets, liabilities and equity of an entity as reported in the statement of financial position.
financial statements	Structured representation of the financial position, financial performance and cash flows of an entity.
financing activities	Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.
firm commitment	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.
first-time adopter of the FRSME	An entity that presents its first annual financial statements that conform to the FRSME, regardless of whether its previous accounting framework was full IFRSs or another set of accounting standards.
forecast transaction	An uncommitted but anticipated future transaction.
EU-adopted IFRS	International Financial Reporting Standards (IFRSs) as adopted for use in the European Union, other than the FRSME.
functional currency	The currency of the primary economic environment in which the entity operates.

funding (of post-employment benefits)	Contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid.
gains	Increases in economic benefits that meet the definition of income but are not revenue.
general purpose financial statements	Financial statements directed to the general financial information needs of a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.
going concern	An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.
goodwill	Future economic benefits arising from assets that are not capable of being individually identified and separately recognised.
government grants	Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.
grant date	The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets,

or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

**gross investment
in a lease**

The aggregate of:

- (a) the minimum lease payments receivable by the lessor under a finance lease, and
- (b) any unguaranteed residual value accruing to the lessor.

group

A parent and all its subsidiaries.

hedged item

For the purpose of special hedge accounting under Section 12 of this FRS, a hedged item is:

- (a) interest rate risk of a debt instrument measured at amortised cost;
- (b) foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction;
- (c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or
- (d) foreign exchange risk in a net investment in a foreign operation.

**hedging
instrument**

For the purpose of special hedge accounting by entities within the scope of this FRS under Section 12 of this FRS, a hedging instrument is a financial instrument that meets all of the following terms and conditions:

- (a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 12.17 that is designated as the hedged risk.
- (b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on).
- (c) its notional amount is equal to the designated amount of the principal or notional amount of the hedged item.
- (d) it has a specified maturity date not later than
 - (i) the maturity of the financial instrument being hedged,
 - (ii) the expected settlement of the commodity purchase or sale commitment, or
 - (iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.
- (e) it has no prepayment, early termination or extension features.

An entity that chooses to apply IAS 39 in accounting for financial instruments shall apply the definition of hedging instrument in that standard rather than this definition.

highly probable	Significantly more likely than probable.
impairment loss	The amount by which the carrying amount of an asset exceeds (a) in the case of inventories, its selling price less costs to complete and sell or (b) in the case of other assets, its fair value less costs to sell.
impracticable	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.
imputed rate of interest	The more clearly determinable of either: <ul style="list-style-type: none"> (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating, or (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.
income	Increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.
income statement	Financial statement that presents all items of income and expense recognised in a reporting period, excluding the items of other comprehensive income.

- income tax** All domestic and foreign taxes that are based on taxable profits. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.
- insurance contract** A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
- intangible asset** An identifiable non-monetary asset without physical substance. Such an asset is identifiable when it:
- (a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability, or
 - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- interest rate implicit in the lease** The discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.

interim financial report	A financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period.
interim period	A financial reporting period shorter than a full financial year.
International Financial Reporting Standards (IFRSs)	Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise: <ul style="list-style-type: none"> (a) International Financial Reporting Standards; (b) International Accounting Standards; and (c) Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).
intrinsic value	The difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of CU15, on a share with a fair value of CU20, has an intrinsic value of CU5.
inventories	Assets: <ul style="list-style-type: none"> (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

investing activities The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

investment property Property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes, or
- (b) sale in the ordinary course of business.

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

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

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

lease	An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
lessee's incremental borrowing rate of interest	The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.
liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
loans payable	Financial liabilities other than short-term trade payables on normal credit terms.
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
measurement	The process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the statement of financial position and statement of comprehensive income.

monetary items	Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.
multi-employer (benefit) plans	Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that: <ul style="list-style-type: none"> (a) pool the assets contributed by various entities that are not under common control, and (b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.
net investment in a lease	The gross investment in a lease discounted at the interest rate implicit in the lease.
non-controlling interest	The equity in a subsidiary not attributable, directly or indirectly, to a parent.
notes (to financial statements)	Notes contain information in addition to that presented in the statement of financial position, statement of comprehensive income, income statement (if presented), combined statement of income and retained earnings (if presented), statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.

notional amount	The quantity of currency units, shares, bushels, pounds or other units specified in a financial instrument contract.
objective of financial statements	To provide information about the financial position, performance and cash flows of an entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
onerous contract	A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a finance lease.
operating segment	An operating segment is a component of an entity: <ul style="list-style-type: none"> (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity); (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and (c) for which discrete financial information is available.

other comprehensive income	Items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by this FRS.
owners	Holders of instruments classified as equity.
parent	An entity that has one or more subsidiaries.
performance	The relationship of the income and expenses of an entity, as reported in the statement of comprehensive income.
plan assets (of an employee benefit plan)	(a) Assets held by a long-term employee benefit fund, and (b) qualifying insurance policies.
post-employment benefits	Employee benefits (other than termination benefits) that are payable after the completion of employment.
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.
present value	A current estimate of the present discounted value of the future net cash flows in the normal course of business.
presentation currency	The currency in which the financial statements are presented.
probable	More likely than not.
profit or loss	The total of income less expenses, excluding the components of other comprehensive income.

projected unit credit method	An actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (sometimes known as the accrued benefit method pro rated on service or as the benefit/years of service method).
property, plant and equipment	Tangible assets that: <ul style="list-style-type: none"> (a) are held for use in the production or supply of goods or services, for rental to others, for investment, or for administrative purposes, and (b) are expected to be used during more than one period.
prospective application (of a change in accounting policy)	Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed.
provision	A liability of uncertain timing or amount.
prudence	The inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

**public
accountability**

An entity has public accountability if:

- (a) as at the reporting date, its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
- (b) as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit-taking entity for a broad group of outsiders. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

**publicly traded
(debt or equity
instruments)**

Traded, or in process of being issued for trading, in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

recognition

The process of incorporating in the statement of financial position or statement of comprehensive income an item that meets the definition of an element and that satisfies the following criteria:

- (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and
- (b) the item has a cost or value that can be measured with reliability.

recoverable amount

The higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.

related party

A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
 - (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity
- (b) An entity is related to a reporting entity if any of the following conditions applies:
 - (i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) either entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member).
 - (iii) both entities are joint ventures of the same third party.

- (iv) either entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) the entity is controlled or jointly controlled by a person identified in (a).
- (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

related party transaction

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

relevance

The quality of information that allows it to influence the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

reliability

The quality of information that makes it free from material error and bias and represent faithfully that which it either purports to represent or could reasonably be expected to represent.

reporting date	The end of the latest period covered by financial statements or by an interim financial report.
reporting period	The period covered by financial statements or by an interim financial report.
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
residual value (of an asset)	The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
retrospective application (of a change in accounting policy)	Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
revenue	The gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.
separate financial statements	Those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

service concession arrangement	An arrangement whereby a government or other public sector body contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals.
share-based payment transaction	A transaction in which the entity receives goods or services (including employee services) as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other equity instruments of the entity.
state	A national, regional, or local government.
state (employee benefit) plan	Employee benefit plans established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.
statement of cash flows	Financial statement that provides information about the changes in cash and cash equivalents of an entity for a period, showing separately changes during the period from operating, investing and financing activities.

statement of changes in equity	Financial statement that presents the profit or loss for a period, items of income and expense recognised directly in equity for the period, the effects of changes in accounting policy and corrections of errors recognised in the period, and (depending on the format of the statement of changes in equity chosen by the entity) the amounts of transactions with equity holders acting in their capacity as equity holders during the period.
statement of comprehensive income	Financial statement that presents all items of income and expense recognised in a period, including those items recognised in determining profit or loss (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
statement of financial position	Financial statement that presents the relationship of an entity's assets, liabilities and equity as of a specific date (also called the balance sheet).
statement of income and retained earnings	Financial statement that presents the profit or loss and changes in retained earnings for a period.
subsidiary	An entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

substantively enacted	Tax rates shall be regarded as substantively enacted when future events required by the enactment process will not change the outcome.
tax base	The amount attributed to an asset or liability for tax purposes.
tax expense	The aggregate amount included in total comprehensive income or equity for the reporting period in respect of current tax and deferred tax.
taxable profit (tax loss)	The profit (loss) for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the taxation authorities. Taxable profit equals taxable income less amounts deductible from taxable income.
temporary differences	Differences between the carrying amount of an asset, liability or other item in the financial statements and its tax basis that the entity expects will affect taxable profit when the carrying amount of the asset or liability is recovered or settled (or, in the case of items other than assets and liabilities, will affect taxable profit in the future).
termination benefits	Employee benefits payable as a result of either: <ul style="list-style-type: none"> (a) an entity's decision to terminate an employee's employment before the normal retirement date, or (b) an employee's decision to accept voluntary redundancy in exchange for those benefits.

timing differences	Income or expenses that are recognised in profit or loss in one period but, under tax laws or regulations, are included in taxable income in a different period.
timeliness	Providing the information in financial statements within the decision time frame.
total comprehensive income	The change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners (equal to the sum of profit or loss and other comprehensive income).
treasury shares	An entity's own equity instruments, held by the entity or other members of the consolidated group.
understandability	The quality of information in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.
useful life	The period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
value in use	The present value of the future cash flows expected to be derived from an asset or cash-generating unit.
venturer	A party to a joint venture that has joint control over that joint venture.

- vest** Become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.
- vested benefits** Benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

SECTION III

SUMMARY OF PROPOSED AMENDMENTS MADE TO THE IFRS FOR SMEs

SUMMARY OF PROPOSED AMENDMENTS MADE TO THE IFRS FOR SMEs

The Financial Reporting Standard for Medium-sized Entities [FRSME] is the IASB's IFRS for SMEs as published in July 2009 amended as follows (deleted text is struck-through and underline text is inserted). To assist readers, the paragraphs amended are shaded in the FRSME.

- 1 The preface is deleted. Throughout the document, references to the IFRS for SMEs are replaced with references to the FRSME. Paragraph 3.2(b) is deleted.
- 2 Paragraph 2.50 is amended as follows:

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

- (a) ~~investments in associates and joint ventures that an entity measures at fair value (see paragraphs 14.10 and 15.15 respectively).~~ [not used]
 - (b) **investment property** that an entity measures at fair value (see paragraph 16.7).
 - (c) agricultural assets (**biological assets** and **agricultural produce** at the point of harvest) that an entity measures at fair value less estimated costs to sell (see paragraph 34.2).
- 3 Paragraph 4.4 is amended as follows:

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 4.5-4.8, ~~except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, all assets and~~

~~liabilities shall be presented in order of approximate liquidity (ascending or descending).~~

- 4 Paragraph 5.10 is amended as follows and paragraph 5.10A is inserted:

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

Ordinary activities are any activities which are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, these activities. Ordinary activities include any effects on the reporting entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events.

5.10A Extraordinary items are material items possessing a high degree of abnormality which arise from events or transactions that fall outside the ordinary activities of the reporting entity and which are not expected to recur. They do not include the additional line items required by paragraph 5.9, nor do they include prior period items merely because they relate to a prior period.

- 5 Paragraph 7.1A is inserted as follows:

A parent entity which presents **separate financial statements** with its **consolidated financial statements** may elect not to include a statement of cash flows in those separate financial statements.

- 6 Paragraph 9.1 is amended as follows:

~~This section defines the circumstances in which an entity presents **consolidated financial statements** and the procedures for preparing those statements. This section applies where an entity is required to prepare group accounts (consolidated financial statements) in accordance with the Companies Act 2006 ('the Act'). An entity which is permitted by paragraph 1.1 to apply this FRS prepares group accounts in accordance with the Act. It also includes guidance on **separate financial statements** and **combined financial statements**.~~

- 7 Paragraph 9.3 is deleted.

- 8 Paragraph 9.16 is amended as follows:

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same **reporting date** unless it is ~~impracticable to do so~~. the provisions of Schedule 6, paragraph 2(2) of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 are applied.

- 9 Paragraph 11.41(d) is amended as follows:

Financial liabilities measured at fair value through profit or loss (paragraphs 12.8 and 12.9). Financial liabilities that are not held as part of a trading portfolio and are not derivatives shall be shown separately.

- 10 Paragraph 11.48(a)(ii) is amended as follows:

Financial liabilities measured at fair value through profit or loss (with separate disclosure of movements on those which are not held as part of a trading portfolio and are not derivatives).

11 Paragraph 11.48A is inserted:

Financial instruments at fair value

The following disclosures are required only for financial instruments at fair value that are not investments in equity, are not held as part of a trading portfolio and are not derivatives:

- (a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:
 - (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
 - (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.
- (b) the method used to establish the amount of change attributable to changes in own credit risk, or, if the change cannot be measured reliably or is not material, that fact.
- (c) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.
- (d) if an instrument contains both a liability and an equity feature, and the instrument has multiple features that substantially modify the cash flows and the values of those features are interdependent (such as a callable convertible debt instrument), the existence of these features.

- (e) any difference between the fair value at initial recognition and the amount that would be determined at that date using a valuation technique, and the amount recognised in profit or loss.
- (f) information that enables users of the entity's financial statements to evaluate the nature and extent of relevant risks arising from financial instruments to which the entity is exposed at the end of the reporting period. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk. The disclosure should include both the entity's exposure to each type of risk and how it manages those risks.

12 Paragraph 12.8A is added:

For financial instruments in the scope of this section that are not held for trading and are not derivative instruments, an entity shall provide additional disclosures as set out in paragraph 11.48A.

13 Paragraphs 14.4 and 14.5 are amended as follows; paragraphs 14.7, 14.9, 14.10 and 14.15 are deleted and paragraph 14.4A is inserted:

14.4 An investor which is not a parent but that has an investment in one or more associates shall account for all of its investments in associates using one of the following—the cost model in paragraph 14.5.

~~(a) the cost model in paragraph 14.5~~

~~(b) the equity method in paragraph 14.8~~

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

14.4A An investor which is a parent shall, in its consolidated financial statements, account for all of its investments in associates using the equity method in paragraph 14.8.

Cost model

- 14.5 An investor ~~which is not a parent~~ shall measure its investments in associates, ~~other than those for which there is a published price quotation (see paragraph 44.7)~~ at cost less any accumulated impairment losses recognised in accordance with section 27 *Impairment of Assets*.
- 14 Paragraphs 15.9 and 15.10 are amended as follows; paragraphs 15.12, 15.14, 15.15 and 15.21 are deleted and paragraph 15.9A is inserted:
- 15.9 A venturer ~~which is not a parent but has one or more interests in jointly controlled entities~~ shall account for all of its interests in jointly controlled entities using ~~one of the following~~ the cost model in paragraph 15.10.
- (a) ~~the cost model in paragraph 15.10~~
- (b) ~~the equity method in paragraph 15.13~~
- (c) ~~the **fair value** model in paragraph 15.14~~.
- 15.9A An investor shall, in its consolidated financial statements, account for all of its investments in joint ventures using the equity method in paragraph 15.13.

Cost model

- 15.10 A venturer which is not a parent shall measure its investments in jointly controlled entities, ~~other than those for which there is a published price quotation (see paragraph 15.12)~~, at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.

- 15 Paragraph 19.23(a) is amended as follows:
- (a) An entity shall follow the principles in paragraphs 18.19-18.24 for amortisation of goodwill. ~~If an entity is unable to make a reliable estimate of the useful life of goodwill, the life shall be presumed to be ten years.~~ The life of goodwill shall be presumed to be five years or less unless the goodwill has a longer useful economic life.
- 16 Paragraph 19.24(b) is deleted and replaced with:
- (b) recognise any excess which remains after the reassessment in profit or loss in the periods in which the non-monetary assets acquired are recovered.
- 17 The following sub-paragraph is added to paragraph 19.25:
- (g) the useful life of goodwill, if this exceeds five years, and supporting reasons for this.
- 18 Paragraph 21.9 is amended as follows:
- 21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (eg through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. ~~In the statement of comprehensive income, the entity may offset any reimbursement from another party against the expense relating to the provision.~~
- 19 Paragraph 22.7(a) is deleted.

- 20 Paragraph 27.28 is amended as follows:

An impairment loss recognised for goodwill shall ~~not~~ be reversed in a subsequent period if and only if the reasons for the impairment loss have ceased to apply.

- 21 Paragraph 28.24 is amended as follows:

An entity is required to recognise all actuarial gains and losses in the period in which they occur. An entity shall:

- (a) ~~recognise all actuarial gains and losses in profit or loss, or [not used]~~
- (b) recognise all actuarial gains and losses in other comprehensive income ~~as an accounting policy election. The entity shall apply its chosen accounting policy consistently to all of its defined benefit plans and all of its actuarial gains and losses.~~ Actuarial gains and losses recognised in other comprehensive income shall be presented in the statement of comprehensive income.

- 22 Paragraph 28.28 is amended as follows:

If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. ~~In the statement of comprehensive income (or in the income statement, if presented), the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.~~

23 Section 29 is removed and replaced with the entire text of IAS 12, renumbered appropriately and with the following amendments:

- (a) All references to “this Standard” are replaced with “this Section”, and references to named Standards are replaced with references to the relevant Section of the FRSME;
- (b) The new paragraphs 29.17(c), 29.62(a) and 29.64 are deleted;
- (c) The new paragraph 29.21 is amended as follows:

Goodwill arising in a business combination is measured as the excess of the cost of the business combination over the acquirer’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 19.14. ~~(a) over (b) below:~~

- ~~(a) the aggregate of:~~
 - ~~(i) the consideration transferred measured in accordance with IFRS 3, which generally requires acquisition-date fair value;~~
 - ~~(ii) the amount of any non-controlling interest in the acquiree recognised in accordance with IFRS 3; and~~
 - ~~(iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer’s previously held equity interest in the acquiree.~~
- ~~(b) the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with IFRS 3~~

- (d) The new paragraph 29.33 is amended as follows:

One case when a deferred tax asset arises on initial recognition of an asset is when ~~a non-taxable government grant related to an asset is deducted in arriving at the carrying amount of the asset but, for tax purposes, is not deducted from the asset's depreciable amount (in other words its tax base); the carrying amount of the asset is less than its tax base and this gives rise to a deductible temporary difference.~~ G government grants ~~may also be~~ are set up as deferred income in which case the difference between the deferred income and its tax base of nil is a deductible temporary difference. ~~Whichever method of presentation an entity adopts, t~~The entity does not recognise the resulting deferred tax asset, for the reason given in paragraph 29.22

- 24 Paragraph 33.2 is amended as follows:

A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).

- ~~(a) A person or a close member of that person's family is related to a reporting entity if that person:~~
- ~~(i) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity;~~
 - ~~(ii) has control over the reporting entity; or~~
 - ~~(iii) has joint control or significant influence over the reporting entity or has significant voting power in it.~~

- (a) A person or close member of that person’s family is related to a reporting entity if that person:
- (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
- (i) the entity and the reporting entity are members of the same **group** (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) ~~either one~~ entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member).
 - (iii) both entities are joint ventures of ~~a third entity~~ the same third party.
 - (iv) either entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the ~~plan~~ reporting entity.
 - (vi) the entity is controlled or jointly controlled by a person identified in (a).

~~(vii) a person identified in (a)(i) has significant voting power in the entity.~~

(viii) a person identified in a(ii) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity) ~~or significant voting power in it.~~

~~(ix) a person or a close member of that person's family has both significant influence over the entity or significant voting power in it and joint control over the reporting entity.~~

~~(x) a member of the key management personnel of the entity or of a parent of the entity, or a close member of that member's family, has control or joint control over the reporting entity or has significant voting power in it.~~

25 The following sub-paragraph is added to paragraph 35.10:

(m) ***Dormant companies.*** A company legally classified as dormant may elect to retain its accounting policies for measurement of reported assets, liabilities and equity at the date of transition to this Standard until there is any change to those balances or the company undertakes any new transactions.

26 In the Glossary, the following definitions are amended (deleted text is struck through and underlined text is inserted):

deferred tax assets	Income tax recoverable in future reporting periods in respect of:
	(a) <u>deductible</u> temporary differences;
	(b) the carry forward of unused tax losses; and
	(c) the carry forward of unused tax credits.

deferred tax liabilities Income tax payable in future periods in respect of taxable temporary differences

~~full IFRS~~ **EU-adopted IFRS** International Financial Reporting Standards (IFRS) as adopted for use in the European Union other than the ~~IFRS for SMEs~~ FRSME.

public accountability ~~Accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs.~~ An entity has public accountability if:

- (a) as at the reporting date, its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
- (b) as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit-taking entity for a broad group of outsiders ~~as one of its primary businesses~~. This is typically the case for banks, credit unions, insurance company, securities brokers/dealers, mutual funds and investment banks.

The definition of **small and medium-sized entities** is deleted.

~~**tax-basis tax base**~~

The amount attributed to an asset or liability for tax purposes.

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