

## IAS 11

INTERNATIONAL ACCOUNTING STANDARD IAS 11  
(REVISED 1993)

## Construction Contracts

This revised International Accounting Standard supersedes IAS 11, accounting for construction contracts, approved by the Board in 1978. The revised Standard became effective for financial statements covering periods beginning on or after 1 January 1995.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 45. The amended text becomes effective when IAS 10 (revised 1999) becomes effective, i.e. for annual financial statements covering periods beginning on or after 1 January 2000.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

## OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Standard uses the recognition criteria established in the framework for the preparation and presentation of financial statements to determine when contract revenue and contract costs should be recognised as revenue and expenses in the income statement. It also provides practical guidance on the application of these criteria.

## SCOPE

1. ***This Standard should be applied in accounting for construction contracts in the financial statements of contractors.***
2. This Standard supersedes IAS 11, accounting for construction contracts, approved in 1978.

## DEFINITIONS

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

*A construction contract is 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.*

*A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.*

*A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.*

4. A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel. A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use; examples of such contracts include those for the construction of refineries and other complex pieces of plant or equipment.
5. For the purposes of this Standard, construction contracts include:
- (a) contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
  - (b) contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.
6. Construction contracts are formulated in a number of ways which, for the purposes of this Standard, are classified as fixed price contracts and cost plus contracts. Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example in the case of a cost plus contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 23 and 24 in order to determine when to recognise contract revenue and expenses.

## COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS

7. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard 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.
8. ***When a contract covers a number of assets, the construction of each asset should 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 have been 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.*
9. ***A group of contracts, whether with a single customer or with several customers, should 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*

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- (c) *the contracts are performed concurrently or in a continuous sequence.*
10. *A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset should be treated as a separate construction contract when:*
- (a) *the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or*
- (b) *the price of the asset is negotiated without regard to the original contract price.*

## CONTRACT REVENUE

11. *Contract revenue should comprise:*
- (a) *the initial amount of revenue agreed in the contract; and*
- (b) *variations in contract work, claims and incentive payments:*
- (i) *to the extent that it is probable that they will result in revenue; and*
- (ii) *they are capable of being reliably measured.*
12. Contract revenue is measured at the fair value of the consideration received or receivable. The measurement of contract revenue is affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Therefore, the amount of contract revenue may increase or decrease from one period to the next. For example:
- (a) a contractor and a customer may agree variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;
- (b) the amount of revenue agreed in a fixed price contract may increase as a result of cost escalation clauses;
- (c) the amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or
- (d) when a fixed price contract involves a fixed price per unit of output, contract revenue increases as the number of units is increased.
13. A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset and changes in the duration of the contract. A variation is included in contract revenue when:
- (a) it is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
- (b) the amount of revenue can be reliably measured.
14. A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, claims are only included in contract revenue when:
- (a) negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and
- (b) the amount that it is probable will be accepted by the customer can be measured reliably.

15. Incentive payments are additional amounts paid to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when:
- (a) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
  - (b) the amount of the incentive payment can be measured reliably.

#### CONTRACT COSTS

16. ***Contract costs should comprise:***
- (a) ***costs that relate directly to the specific contract;***
  - (b) ***costs that are attributable to contract activity in general and can be allocated to the contract; and***
  - (c) ***such other costs as are specifically chargeable to the customer under the terms of the contract.***
17. Costs that relate directly to a specific contract include:
- (a) site labour costs, including site supervision;
  - (b) costs of materials used in construction;
  - (c) depreciation of plant and equipment used on the contract;
  - (d) costs of moving plant, equipment and materials to and from the contract site;
  - (e) costs of hiring plant and equipment;
  - (f) costs of design and technical assistance that is directly related to the contract;
  - (g) the estimated costs of rectification and guarantee work, including expected warranty costs; and
  - (h) claims from third parties.

These costs may be reduced by any incidental income that is not included in contract revenue, for example income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract.

18. Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:
- (a) insurance;
  - (b) costs of design and technical assistance that is not directly related to a specific contract; and
  - (c) construction overheads.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs when the contractor adopts the allowed alternative treatment in IAS 23, borrowing costs.

19. Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.

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20. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:
- (a) general administration costs for which reimbursement is not specified in the contract;
  - (b) selling costs;
  - (c) research and development costs for which reimbursement is not specified in the contract; and
  - (d) depreciation of idle plant and equipment that is not used on a particular contract.
21. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, costs that relate directly to a contract and which are incurred in securing the contract are also included as part of the contract costs if they can be separately identified and measured reliably and it is probable that the contract will be obtained. When costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

## RECOGNITION OF CONTRACT REVENUE AND EXPENSES

22. ***When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 36.***
23. ***In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:***
- (a) ***total contract revenue can be measured reliably;***
  - (b) ***it is probable that the economic benefits associated with the contract will flow to the enterprise;***
  - (c) ***both the contract costs to complete the contract and the stage of contract completion at the balance sheet date can be measured reliably; and***
  - (d) ***the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.***
24. ***In the case of a cost plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:***
- (a) ***it is probable that the economic benefits associated with the contract will flow to the enterprise; and***
  - (b) ***the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.***
25. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.
26. Under the percentage of completion method, contract revenue is recognised as revenue in the income statement in the accounting periods in which the work is performed. Contract costs are usually recognised as an expense in the income statement in the accounting periods in which the work to which they relate is performed. However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 36.
27. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.

28. The outcome of a construction contract can only be estimated reliably when it is probable that the economic benefits associated with the contract will flow to the enterprise. However, when an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the income statement, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.
29. An enterprise is generally able to make reliable estimates after it has agreed to a contract which establishes:
- each party's enforceable rights regarding the asset to be constructed;
  - the consideration to be exchanged; and
  - the manner and terms of settlement.

It is also usually necessary for the enterprise to have an effective internal financial budgeting and reporting system. The enterprise reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

30. The stage of completion of a contract may be determined in a variety of ways. The enterprise uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:
- the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;
  - surveys of work performed; or
  - completion of a physical proportion of the contract work.

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

31. When the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included in costs incurred to date. Examples of contract costs which are excluded are:
- contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract; and
  - payments made to subcontractors in advance of work performed under the subcontract.
32. ***When the outcome of a construction contract cannot be estimated reliably:***
- revenue should be recognised only to the extent of contract costs incurred that it is probable will be recoverable; and***
  - contract costs should be recognised as an expense in the period in which they are incurred.***

***An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 36.***

33. During the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the enterprise will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no profit is recognised. However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract costs will exceed total contract revenues. In such cases, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 36.

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34. Contract costs that are not probable of being recovered are recognised as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable and in which contract costs may need to be recognised as an expense immediately include contracts:
- (a) which are not fully enforceable, that is, their validity is seriously in question;
  - (b) the completion of which is subject to the outcome of pending litigation or legislation;
  - (c) relating to properties that are likely to be condemned or expropriated;
  - (d) where the customer is unable to meet its obligations; or
  - (e) where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.
35. ***When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 22 rather than in accordance with paragraph 32.***

## RECOGNITION OF EXPECTED LOSSES

36. ***When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.***
37. The amount of such a loss is determined irrespective of:
- (a) whether or not work has commenced on the contract;
  - (b) the stage of completion of contract activity; or
  - (c) the amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with paragraph 9.

## CHANGES IN ESTIMATES

38. The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see IAS 8, Net profit or loss for the period, fundamental errors and changes in accounting policies). The changed estimates are used in the determination of the amount of revenue and expenses recognised in the income statement in the period in which the change is made and in subsequent periods.

## DISCLOSURE

39. ***An enterprise should disclose:***
- (a) ***the amount of contract revenue recognised as revenue in the period;***
  - (b) ***the methods used to determine the contract revenue recognised in the period; and***
  - (c) ***the methods used to determine the stage of completion of contracts in progress.***
40. ***An enterprise should disclose each of the following for contracts in progress at the balance sheet date:***
- (a) ***the aggregate amount of costs incurred and recognised profits (less recognised losses) to date;***

- (b) *the amount of advances received; and*
- (c) *the amount of retentions.*
41. Retentions are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts received by the contractor before the related work is performed.
42. ***An enterprise should present:***
- (a) *the gross amount due from customers for contract work as an asset; and*
- (b) *the gross amount due to customers for contract work as a liability.*
43. The gross amount due from customers for contract work is the net amount of:
- (a) costs incurred plus recognised profits; less
- (b) the sum of recognised losses and progress billings
- for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds progress billings.
44. The gross amount due to customers for contract work is the net amount of:
- (a) costs incurred plus recognised profits; less
- (b) the sum of recognised losses and progress billings
- for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).
45. An enterprise discloses any contingent liabilities and contingent assets in accordance with IAS 37, provisions, contingent liabilities and contingent assets. Contingent liabilities and contingent assets may arise from such items as warranty costs, claims, penalties or possible losses.

**EFFECTIVE DATE**

46. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1995.***

**INTERNATIONAL ACCOUNTING STANDARD IAS 12  
(REVISED 2000)****Income taxes**

In October 1996, the Board approved a revised Standard, IAS 12 (revised 1996), income taxes which superseded IAS 12 (reformatted 1994), accounting for taxes on income. The revised Standard became effective for financial statements covering periods beginning on or after 1 January 1998.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 88. The amended text became effective for annual financial statements covering periods beginning on or after 1 January 2000.

In April 2000, paragraphs 20, 62(a), 64 and Appendix A, paragraphs A10, A11 and B8 were amended to revise cross-references and terminology as a result of the issuance of IAS 40, investment property.

**IAS 12**

In October 2000, the Board approved amendments to IAS 12 which added paragraphs 52A, 52B, 65A, 81(i), 82A, 87A, 87B, 87C and 91 and deleted paragraphs 3 and 50. The limited revisions specify the accounting treatment for income tax consequences of dividends. The revised text was effective for annual financial statements covering periods beginning on or after 1 January 2001.

The following SIC interpretations relate to IAS 12:

- SIC-21: income taxes — recovery of revalued non-depreciable assets, and
- SIC-25: income taxes — changes in the tax status of an enterprise or its shareholders.

**INTRODUCTION**

This Standard ('IAS 12 (revised)') replaces IAS 12, accounting for taxes on income ('the original IAS 12'). IAS 12 (revised) is effective for accounting periods beginning on or after 1 January 1998. The major changes from the original IAS 12 are as follows.

1. The original IAS 12 required an enterprise to account for deferred tax using either the deferral method or a liability method which is sometimes known as the income statement liability method. IAS 12 (revised) prohibits the deferral method and requires another liability method which is sometimes known as the balance sheet liability method.

The income statement liability method focuses on timing differences, whereas the balance sheet liability method focuses on temporary differences. Timing differences are differences between taxable profit and accounting profit that originate in one period and reverse in one or more subsequent periods. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the balance sheet. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

All timing differences are temporary differences. Temporary differences also arise in the following circumstances, which do not give rise to timing differences, although the original IAS 12 treated them in the same way as transactions that do give rise to timing differences:

- (a) subsidiaries, associates or joint ventures have not distributed their entire profits to the parent or investor;
- (b) assets are revalued and no equivalent adjustment is made for tax purposes; and
- (c) the cost of a business combination that is an acquisition is allocated to the identifiable assets and liabilities acquired, by reference to their fair values but no equivalent adjustment is made for tax purposes.

Furthermore, there are some temporary differences which are not timing differences, for example those temporary differences that arise when:

- (a) the non-monetary assets and liabilities of a foreign operation that is integral to the operations of the reporting entity are translated at historical exchange rates;
- (b) non-monetary assets and liabilities are restated under IAS 29, financial reporting in hyperinflationary economies; or
- (c) the carrying amount of an asset or liability on initial recognition differs from its initial tax base.

## IAS 12

2. The original IAS 12 permitted an enterprise not to recognise deferred tax assets and liabilities where there was reasonable evidence that timing differences would not reverse for some considerable period ahead. IAS 12 (revised) requires an enterprise to recognise a deferred tax liability or (subject to certain conditions) asset for all temporary differences, with certain exceptions noted below.
3. The original IAS 12 required that:
  - (a) deferred tax assets arising from timing differences should be recognised when there was a reasonable expectation of realisation; and
  - (b) deferred tax assets arising from tax losses should be recognised as an asset only where there was assurance beyond any reasonable doubt that future taxable income would be sufficient to allow the benefit of the loss to be realised. The original IAS 12 permitted (but did not require) an enterprise to defer recognition of the benefit of tax losses until the period of realisation.

IAS 12 (revised) requires that deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised. Where an enterprise has a history of tax losses, the enterprise recognises a deferred tax asset only to the extent that the enterprise has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available.

4. As an exception to the general requirement set out in paragraph 2 above, IAS 12 (revised) prohibits the recognition of deferred tax liabilities and deferred tax assets arising from certain assets or liabilities whose carrying amount differs on initial recognition from their initial tax base. Because such circumstances do not give rise to timing differences, they did not result in deferred tax assets or liabilities under the original IAS 12.
5. The original IAS 12 required that taxes payable on undistributed profits of subsidiaries and associates should be recognised unless it was reasonable to assume that those profits will not be distributed or that a distribution would not give rise to a tax liability. However, IAS 12 (revised) prohibits the recognition of such deferred tax liabilities (and those arising from any related cumulative translation adjustment) to the extent that:
  - (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.

Where this prohibition has the result that no deferred tax liabilities have been recognised, IAS 12 (revised) requires an enterprise to disclose the aggregate amount of the temporary differences concerned.

6. The original IAS 12 did not refer explicitly to fair value adjustments made on a business combination. Such adjustments give rise to temporary differences and IAS 12 (revised) requires an enterprise to recognise the resulting deferred tax liability or (subject to the probability criterion for recognition) deferred tax asset with a corresponding effect on the determination of the amount of goodwill or negative goodwill. However, IAS 12 (revised) prohibits the recognition of deferred tax liabilities arising from goodwill itself (if amortisation of the goodwill is not deductible for tax purposes) and of deferred tax assets arising from negative goodwill that is treated as deferred income.
7. The original IAS 12 permitted, but did not require, an enterprise to recognise a deferred tax liability in respect of asset revaluations. IAS 12 (revised) requires an enterprise to recognise a deferred tax liability in respect of asset revaluations.

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8. The tax consequences of recovering the carrying amount of certain assets or liabilities may depend on the manner of recovery or settlement, for example:
- (a) in certain countries, capital gains are not taxed at the same rate as other taxable income; and
  - (b) in some countries, the amount that is deducted for tax purposes on sale of an asset is greater than the amount that may be deducted as depreciation.

The original IAS 12 gave no guidance on the measurement of deferred tax assets and liabilities in such cases. IAS 12 (revised) requires that the measurement of deferred tax liabilities and deferred tax assets should be based on the tax consequences that would follow from the manner in which the enterprise expects to recover or settle the carrying amount of its assets and liabilities.

9. The original IAS 12 did not state explicitly whether deferred tax assets and liabilities may be discounted. IAS 12 (revised) prohibits discounting of deferred tax assets and liabilities. An amendment to paragraph 39(i) of IAS 22, business combinations, prohibits discounting of deferred tax assets and liabilities acquired in a business combination. Previously, paragraph 39(i) of IAS 22 neither prohibited nor required discounting of deferred tax assets and liabilities resulting from a business combination.
10. The original IAS 12 did not specify whether an enterprise should classify deferred tax balances as current assets and liabilities or as non-current assets and liabilities. IAS 12 (revised) requires that an enterprise which makes the current/non-current distinction should not classify deferred tax assets and liabilities as current assets and liabilities.
11. The original IAS 12 stated that debit and credit balances representing deferred taxes may be offset. IAS 12 (revised) establishes more restrictive conditions on offsetting, based largely on those for financial assets and liabilities in IAS 32, financial instruments: disclosure and presentation.
12. The original IAS 12 required disclosure of an explanation of the relationship between tax expense and accounting profit if not explained by the tax rates effective in the reporting enterprise's country. IAS 12 (revised) requires this explanation to take 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); or
  - (ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate.

IAS 12 (revised) also requires an explanation of changes in the applicable tax rate(s) compared to the previous accounting period.

13. New disclosures required by IAS 12 (revised) include:
- (a) in respect of each type of temporary difference, unused tax losses and unused tax credits:
    - (i) the amount of deferred tax assets and liabilities recognised; and
    - (ii) the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet;

- (b) 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; and
- (c) the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:
  - (i) 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
  - (ii) the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

**OBJECTIVE**

The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

- (a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an enterprise's balance sheet; and
- (b) transactions and other events of the current period that are recognised in an enterprise's financial statements.

It is inherent in the recognition of an asset or liability that the reporting enterprise expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Standard requires an enterprise to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions.

This Standard requires an enterprise to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill or negative goodwill arising in that business combination.

This Standard also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes.

## SCOPE

1. ***This Standard should be applied in accounting for income taxes.***
2. For the purposes of this Standard, 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 enterprise.
3. (Deleted)
4. This Standard does not deal with the methods of accounting for government grants (see IAS 20, accounting for government grants and disclosure of government assistance) or investment tax credits. However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

## DEFINITIONS

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

***Accounting profit is net 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 net 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 balance sheet 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.***

6. Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

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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 enterprise 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.

*Exa mp l e s*

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 <sup>(1)</sup>.
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.
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.

*Exa mp l e s*

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 <sup>(2)</sup>.
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.

<sup>(1)</sup> 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.

<sup>(2)</sup> 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.

9. Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. 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.
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 Standard is based: that an enterprise should, 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 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.
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 enterprise in the group.

#### RECOGNITION OF CURRENT TAX LIABILITIES AND CURRENT TAX ASSETS

12. ***Current tax for current and prior periods should, 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 should be recognised as an asset.***
13. ***The benefit relating to a tax loss that can be carried back to recover current tax of a previous period should be recognised as an asset.***
14. When a tax loss is used to recover current tax of a previous period, an enterprise 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 enterprise and the benefit can be reliably measured.

#### RECOGNITION OF DEFERRED TAX LIABILITIES AND DEFERRED TAX ASSETS

##### *Taxable temporary differences*

15. ***A deferred tax liability should be recognised for all taxable temporary differences, unless the deferred tax liability arises from:***
  - (a) *goodwill for which amortisation is not deductible for tax purposes; 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 should be recognised in accordance with paragraph 39.***

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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 enterprise 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 enterprise recovers the carrying amount of the asset, the taxable temporary difference will reverse and the enterprise will have taxable profit. This makes it probable that economic benefits will flow from the enterprise in the form of tax payments. Therefore, this Standard requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.

**Example**

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 enterprise must earn taxable income of 100, but will only be able to deduct tax depreciation of 60. Consequently, the enterprise 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 enterprise 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.

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 balance sheet with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected;
  - (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); and
  - (c) development costs may be capitalised and amortised over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred. Such development costs have a tax base of nil as they have already been deducted from taxable profit. The temporary difference is the difference between the carrying amount of the development costs and their tax base of nil.
18. Temporary differences also arise when:
- (a) the cost of a business combination that is an acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values but no equivalent adjustment is made for tax purposes (see paragraph 19);
  - (b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);

- (c) goodwill or negative goodwill arises on consolidation (see paragraphs 21 and 32);
- (d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an enterprise benefits from non-taxable government grants related to assets (see paragraphs 22 and 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 38 to 45).

#### Business combinations

19. In a business combination that is an acquisition, the cost of the acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values at the date of the exchange transaction. Temporary differences arise when the tax bases of the identifiable assets and liabilities acquired 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 66).

#### Assets carried at fair value

20. International Accounting Standards permit certain assets to be carried at fair value or to be revalued (see, for example, IAS 16, property, plant and equipment, IAS 38, intangible assets, IAS 39, financial instruments: recognition and measurement, and IAS 40, 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 enterprise 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 enterprise 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

21. Goodwill is the excess of the cost of an acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired. Many taxation authorities do not allow the amortisation 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 Standard does not permit the recognition of the resulting deferred tax liability because goodwill is a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

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## Initial recognition of an asset or liability

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 which led to the initial recognition of the asset:
- (a) in a business combination, an enterprise recognises any deferred tax liability or asset and this affects the amount of goodwill or negative goodwill (see paragraph 19);
  - (b) if the transaction affects either accounting profit or taxable profit, an enterprise recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in the income statement (see paragraph 59);
  - (c) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an enterprise would, in the absence of the exemption provided by paragraphs 15 and 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 Standard does not permit an enterprise to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example on next page). Furthermore, an enterprise does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.
23. In accordance with IAS 32, financial instruments: disclosure and presentation, 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 15(b) does not apply. Consequently, an enterprise recognises the resulting deferred tax liability. In accordance with paragraph 61, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58, subsequent changes in the deferred tax liability are recognised in the income statement as deferred tax expense (income).

## Example illustrating paragraph 22(c)

An enterprise 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 enterprise will earn taxable income of 1 000 and pay tax of 400. The enterprise 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 enterprise will pay tax of 320. The enterprise does not recognise the deferred tax liability of 320 because it results from the initial recognition of the asset.

*Deductible temporary differences*

24. ***A deferred tax asset should 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:***
- (a) ***negative goodwill which is treated as deferred income in accordance with IAS 22, business combinations; 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 deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset should be recognised in accordance with paragraph 44.***

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 enterprise of resources embodying economic benefits. When resources flow from the enterprise, 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 enterprise recognises a liability of 100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the enterprise 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 enterprise 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 enterprise recognises a deferred tax asset of 25 (100 at 25 %), provided that it is probable that the enterprise will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.

26. The following are examples of deductible temporary differences which 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 enterprise or when retirement benefits are paid by the enterprise. 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 enterprise 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) in a business combination that is an acquisition, the cost of the acquisition is allocated to the assets and liabilities recognised, by reference to their fair values at the date of the exchange transaction. When a liability is recognised on the acquisition 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 where 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 66); and

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(d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

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 enterprise only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an enterprise recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

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. 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 enterprise 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 enterprise 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 enterprise that will create taxable profit in appropriate periods.

30. Tax planning opportunities are actions that the enterprise 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.

31. When an enterprise has a history of recent losses, the enterprise considers the guidance in paragraphs 35 and 36.

## Negative goodwill

32. This Standard does not permit the recognition of a deferred tax asset arising from deductible temporary differences associated with negative goodwill which is treated as deferred income in accordance with IAS 22, business combinations, because negative goodwill is a residual and the recognition of the deferred tax asset would increase the carrying amount of negative goodwill.

## Initial recognition of an asset or liability

33. 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. Government grants may also be 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 enterprise adopts, the enterprise does not recognise the resulting deferred tax asset, for the reason given in paragraph 22.

## Unused tax losses and unused tax credits

34. ***A deferred tax asset should 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.***
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 enterprise has a history of recent losses, the enterprise recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the enterprise 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 enterprise. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.
36. An enterprise 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 enterprise 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 enterprise 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 30) are available to the enterprise 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.

**IAS 12***Reassessment of unrecognised deferred tax assets*

37. At each balance sheet date, an enterprise reassesses unrecognised deferred tax assets. The enterprise 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 enterprise will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraphs 24 or 34. Another example is when an enterprise reassesses deferred tax assets at the date of a business combination or subsequently (see paragraphs 67 and 68).

*Investments in subsidiaries, branches and associates and interests in joint ventures*

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.

39. ***An enterprise should 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.***
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.
41. An enterprise accounts in its own currency for the non-monetary assets and liabilities of a foreign operation that is integral to the enterprise's operations (see IAS 21, the effects of changes in foreign exchange rates). Where the foreign operation's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in the foreign currency, changes in the exchange rate give rise to temporary differences. Because such temporary differences relate to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation, the reporting enterprise recognises the resulting deferred tax liability or (subject to paragraph 24) asset. The resulting deferred tax is charged or credited in the income statement (see paragraph 58).

42. An investor in an associate does not control that enterprise 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.
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.
44. ***An enterprise should 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.*
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 enterprise considers the guidance set out in paragraphs 28 to 31.

## MEASUREMENT

46. ***Current tax liabilities (assets) for the current and prior periods should 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 balance sheet date.***
47. ***Deferred tax assets and liabilities should 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 balance sheet date.***
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).
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.
50. (Deleted)
51. ***The measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.***

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52. In some jurisdictions, the manner in which an enterprise recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

- (a) the tax rate applicable when the enterprise recovers (settles) the carrying amount of the asset (liability); and
- (b) the tax base of the asset (liability).

In such cases, an enterprise 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 enterprise 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 enterprise 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 enterprise 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	<u>50</u>	nil	<u>—</u>
Total	<u>80</u>		<u>9</u>

Note: in accordance with paragraph 61, the additional deferred tax that arises on the revaluation is charged directly to equity.

**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 enterprise 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 enterprise expects to recover the carrying amount by selling the asset immediately for proceeds of 150, the enterprise 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 61, the additional deferred tax that arises on the revaluation is charged directly to equity.

- 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 enterprise. 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 enterprise. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.
- 52B. In the circumstances described in paragraph 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 net profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b).

#### Example illustrating paragraphs 52A and 52B

The following example deals with the measurement of current and deferred tax assets and liabilities for an enterprise 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 balance sheet date, 31 December 20X1, the enterprise does not recognise a liability for dividends proposed or declared after the balance sheet date. 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 enterprise 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 enterprise also recognises a deferred tax liability and deferred tax expense of 20 000 (40 000 at 50 %) representing the income taxes that the enterprise 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 enterprise recognises dividends of 10 000 from previous operating profits as a liability.

On 15 March 20X2, the enterprise 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.

53. ***Deferred tax assets and liabilities should not be discounted.***
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 enterprises. Therefore, this Standard does not require or permit the discounting of deferred tax assets and liabilities.

**IAS 12**

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 IAS 19, employee benefits).
56. ***The carrying amount of a deferred tax asset should be reviewed at each balance sheet date. An enterprise should 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 should be reversed to the extent that it becomes probable that sufficient taxable profit will be available.***

## RECOGNITION OF CURRENT AND DEFERRED TAX

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 58 to 68 implement this principle.

*Income statement*

58. ***Current and deferred tax should be recognised as income or an expense and included in the net 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, directly in equity (see paragraphs 61 to 65); or***
  - (b) ***a business combination that is an acquisition (see paragraphs 66 to 68).***
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 the income statement. Examples are when:
- (a) interest, royalty or dividend revenue is received in arrears and is included in accounting profit on a time apportionment basis in accordance with IAS 18, revenue, but is included in taxable profit (tax loss) on a cash basis; and
  - (b) costs of intangible assets have been capitalised in accordance with IAS 38, intangible assets, and are being amortised in the income statement, but were deducted for tax purposes when they were incurred.
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 the income statement, except to the extent that it relates to items previously charged or credited to equity (see paragraph 63).

*Items credited or charged directly to equity*

61. ***Current tax and deferred tax should be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.***

62. International Accounting Standards require or permit certain items to be credited or charged directly to equity. Examples of such items are:
- (a) a change in carrying amount arising from the revaluation of property, plant and equipment (see IAS 16, property, plant and equipment);
  - (b) 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 a fundamental error (see IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies);
  - (c) exchange differences arising on the translation of the financial statements of a foreign entity (see IAS 21, the effects of changes in foreign exchange rates); and
  - (d) amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 23).
63. In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items credited or charged to 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 charged or credited to equity; or
  - (c) an enterprise 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 charged or credited to equity.

In such cases, the current and deferred tax related to items that are credited or charged to equity is 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.

64. IAS 16, property, plant and equipment, does not specify whether an enterprise should transfer each year from revaluation surplus to retained earnings an amount equal to the difference between the depreciation or amortisation on a revalued asset and the depreciation or amortisation based on the cost of that asset. If an enterprise makes such a transfer, the amount transferred is net of any related deferred tax. Similar considerations apply to transfers made on disposal of an item of property, plant or equipment.
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 credited or charged to equity 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 the income statement.
- 65A. When an enterprise 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.

**IAS 12***Deferred tax arising from a business combination*

66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination that is an acquisition. In accordance with IAS 22, business combinations, an enterprise recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the date of the acquisition. Consequently, those deferred tax assets and liabilities affect goodwill or negative goodwill. However, in accordance with paragraphs 15(a) and 24(a), an enterprise does not recognise deferred tax liabilities arising from goodwill itself (if amortisation of the goodwill is not deductible for tax purposes) and deferred tax assets arising from non-taxable negative goodwill which is treated as deferred income.
67. As a result of a business combination, an acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised prior to 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. In such cases, the acquirer recognises a deferred tax asset and takes this into account in determining the goodwill or negative goodwill arising on the acquisition.
68. When an acquirer did not recognise a deferred tax asset of the acquiree as an identifiable asset at the date of a business combination and that deferred tax asset is subsequently recognised in the acquirer's consolidated financial statements, the resulting deferred tax income is recognised in the income statement. In addition, the acquirer:
- (a) adjusts the gross carrying amount of the goodwill and the related accumulated amortisation to the amounts that would have been recorded if the deferred tax asset had been recognised as an identifiable asset at the date of the business combination; and
  - (b) recognises the reduction in the net carrying amount of the goodwill as an expense.

However, the acquirer does not recognise negative goodwill, nor does it increase the carrying amount of negative goodwill.

**Example**

An enterprise acquired a subsidiary which had deductible temporary differences of 300. The tax rate at the time of the acquisition was 30 %. The resulting deferred tax asset of 90 was not recognised as an identifiable asset in determining the goodwill of 500 resulting from the acquisition. The goodwill is amortised over 20 years. Two years after the acquisition, the enterprise assessed that future taxable profit would probably be sufficient for the enterprise to recover the benefit of all the deductible temporary differences.

The enterprise recognises a deferred tax asset of 90 (300 at 30 %) and, in the income statement, deferred tax income of 90. It also reduces the cost of the goodwill by 90 and the accumulated amortisation by 9 (representing two years' amortisation). The balance of 81 is recognised as an expense in the income statement. Consequently, the cost of the goodwill, and the related accumulated amortisation, are reduced to the amounts (410 and 41) that would have been recorded if a deferred tax asset of 90 had been recognised as an identifiable asset at the date of the business combination.

If the tax rate has increased to 40 %, the enterprise recognises a deferred tax asset of 120 (300 at 40 %) and, in the income statement, deferred tax income of 120. If the tax rate has decreased to 20 %, the enterprise recognises a deferred tax asset of 60 (300 at 20 %) and deferred tax income of 60. In both cases, the enterprise also reduces the cost of the goodwill by 90 and the accumulated amortisation by 9 and recognises the balance of 81 as an expense in the income statement.

## PRESENTATION

*Tax assets and tax liabilities*

69. ***Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet. Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.***
70. ***When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, it should not classify deferred tax assets (liabilities) as current assets (liabilities).***

## Offset

71. ***An enterprise should offset current tax assets and current tax liabilities if, and only if, the enterprise:***
- (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.***
72. Although current tax assets and liabilities are separately recognised and measured they are offset in the balance sheet subject to criteria similar to those established for financial instruments in IAS 32, financial instruments: disclosure and presentation. An enterprise 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 enterprise to make or receive a single net payment.
73. In consolidated financial statements, a current tax asset of one enterprise in a group is offset against a current tax liability of another enterprise in the group if, and only if, the enterprises concerned have a legally enforceable right to make or receive a single net payment and the enterprises intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.
74. ***An enterprise should offset deferred tax assets and deferred tax liabilities if, and only if:***
- (a) ***the enterprise 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.***
75. To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this Standard requires an enterprise 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 enterprise has a legally enforceable right to set off current tax assets against current tax liabilities.
76. In rare circumstances, an enterprise 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.

**IAS 12***Tax expense*

Tax expense (income) related to profit or loss from ordinary activities

77. ***The tax expense (income) related to profit or loss from ordinary activities should be presented on the face of the income statement.***

Exchange differences on deferred foreign tax liabilities or assets

78. IAS 21, the effects of changes in foreign exchange rates, requires certain exchange differences to be recognised as income or expense but does not specify where such differences should be presented in the income statement. Accordingly, where exchange differences on deferred foreign tax liabilities or assets are recognised in the income statement, 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*

79. ***The major components of tax expense (income) should be disclosed separately.***

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 fundamental errors which are included in the determination of net profit or loss for the period in accordance with the allowed alternative treatment in IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.

81. ***The following should also be disclosed separately:***

- (a) ***the aggregate current and deferred tax relating to items that are charged or credited to equity;***
- (b) ***tax expense (income) relating to extraordinary items recognised during the period;***
- (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 balance sheet;*
  - (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 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 balance sheet for each period presented;*
    - (ii) *the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet;*
  - (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; and*
  - (i) *the amount of income tax consequences of dividends to shareholders of the enterprise that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements.*
- 82. *An enterprise should 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 enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.*
- 82A. *In the circumstances described in paragraph 52A, an enterprise should disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the enterprise should disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.*
- 83. *An enterprise discloses the nature and amount of each extraordinary item either on the face of the income statement or in the notes to the financial statements. When this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items is disclosed on the face of the income statement, net of the aggregate related tax expense (income). Although financial statement users may find the disclosure of the tax expense (income) related to each extraordinary item useful, it is sometimes difficult to allocate tax expense (income) between such items. Under these circumstances tax expense (income) relating to extraordinary items may be disclosed in the aggregate.*

**IAS 12**

84. The disclosures required by paragraph 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.
85. In explaining the relationship between tax expense (income) and accounting profit, an enterprise 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 enterprise 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 enterprise 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.
86. The average effective tax rate is the tax expense (income) divided by the accounting profit.
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 39). Therefore, this Standard requires an enterprise to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, enterprises are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.
- 87A. Paragraph 82A requires an enterprise to disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. An enterprise 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.
- 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 enterprise 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 enterprise 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.
- 87C. An enterprise required to provide the disclosures in paragraph 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 enterprise considers this in determining the information to be disclosed under paragraph 82A. For example, an enterprise 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 81(f)). If it is impracticable to compute the amounts of unrecognised deferred tax liabilities (see paragraph 87) there may be amounts of potential income tax consequences of dividends not practicably determinable related to these subsidiaries.
88. An enterprise discloses any tax-related contingent liabilities and contingent assets in accordance with IAS 37, provisions, contingent liabilities and contingent assets. 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 balance sheet date, an enterprise discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see IAS 10, events after the balance sheet date).

## Example illustrating paragraph 85

In 19X2, an enterprise 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	<u>2 500</u>	<u>3 000</u>
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	<u>(50)</u>	<u>(150)</u>
Tax expense	<u>760</u>	<u>780</u>

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 enterprise's own domestic tax rate and the domestic tax rate in other jurisdictions does not appear as a separate item in the reconciliation. An enterprise 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 81(d).

Accounting profit	<u>2 500</u>	<u>3 000</u>
Tax at the domestic rates applicable to profits in the country concerned	750	750
Tax effect of expenses that are not deductible for tax purposes	<u>60</u>	<u>30</u>
Tax expense	<u>760</u>	<u>780</u>

## EFFECTIVE DATE

89. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January, 1998, except as specified in paragraph 91. If an enterprise applies this Standard for financial statements covering periods beginning before 1 January 1998, the enterprise should disclose the fact it has applied this Standard instead of IAS 12, accounting for taxes on income, approved in 1979.***
90. This Standard supersedes IAS 12, accounting for taxes on income, approved in 1979.
91. ***Paragraphs 52A, 52B, 65A, 81(i), 82A, 87A, 87B, 87C and the deletion of paragraphs 3 and 50 become operative for annual financial statements<sup>(3)</sup> covering periods beginning on or after 1 January 2001. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an enterprise should disclose that fact.***

<sup>(3)</sup> Paragraph 91 refers to 'annual financial statements' in line with more explicit language for writing effective dates adopted in 1998. Paragraph 89 refers to 'financial statements'.

**IAS 14****INTERNATIONAL ACCOUNTING STANDARD IAS 14  
(REVISED 1997)****Segment reporting**

This revised International Accounting Standard supersedes IAS 14, reporting financial information by segment, which was approved by the Board in a reformatted version in 1994. The revised Standard became operative for financial statements covering periods beginning on or after 1 July 1998.

Paragraphs 116 and 117 of IAS 36, impairment of assets, set out certain disclosure requirements for reporting impairment losses by segment.

**INTRODUCTION**

This Standard ('IAS 14 (revised)') replaces IAS 14, reporting financial information by segment ('the original IAS 14'). IAS 14 (revised) is effective for accounting periods beginning on or after 1 July 1998. The major changes from the original IAS 14 are as follows:

1. The original IAS 14 applied to enterprises whose securities are publicly traded and other economically significant entities. IAS 14 (revised) applies to enterprises whose equity or debt securities are publicly traded, including enterprises in the process of issuing equity or debt securities in a public securities market, but not to other economically significant entities.
2. The original IAS 14 required that information be reported for industry segments and geographical segments. It provided only general guidance for identifying industry segments and geographical segments. It suggested that internal organisational groupings may provide a basis for determining reportable segments, or segment reporting may require reclassification of data. IAS 14 (revised) requires that information be reported for business segments and geographical segments. It provides more detailed guidance than the original IAS 14 for identifying business segments and geographical segments. It requires that an enterprise look to its internal organisational structure and internal reporting system for the purpose of identifying those segments. If internal segments are based neither on groups of related products and services nor on geography, IAS 14 (revised) requires that an enterprise should look to the next lower level of internal segmentation to identify its reportable segments.
3. The original IAS 14 required that the same quantity of information be reported for both industry segments and geographical segments. IAS 14 (revised) provides that one basis of segmentation is primary and the other is secondary, with considerably less information required to be disclosed for secondary segments.
4. The original IAS 14 was silent on whether segment information must be prepared using the accounting policies adopted for the consolidated or enterprise financial statements. IAS 14 (revised) requires that the same accounting policies be followed.
5. The original IAS 14 had allowed differences in the definition of segment result among enterprises. IAS 14 (revised) provides more detailed guidance than the original IAS 14 as to specific items of revenue and expense that should be included in or excluded from segment revenue and segment expense. Accordingly, IAS 14 (revised) provides for a standardised measure of segment result, but only to the extent that items of revenue and operating expense can be directly attributed or reasonably allocated to segments.
6. IAS 14 (revised) requires 'symmetry' in the inclusion of items in segment result and in segment assets. If, for example, segment result reflects depreciation expense, the depreciable asset must be included in segment assets. The original IAS 14 was silent on this matter.

**IAS 14**

7. The original IAS 14 was silent on whether segments deemed too small for separate reporting could be combined with other segments or excluded from all reportable segments. IAS 14 (revised) provides that small internally reported segments that are not required to be separately reported may be combined with each other if they share a substantial number of the factors that define a business segment or geographical segment, or they may be combined with a similar significant segment for which information is reported internally if certain conditions are met.
8. The original IAS 14 was silent on whether geographical segments should be based on where the enterprise's assets are located (the origin of its sales) or on where its customers are located (the destination of its sales). IAS 14 (revised) requires that, whichever is the basis of an enterprise's geographical segments, several items of data must be presented on the other basis if significantly different.
9. The original IAS 14 required four principal items of information for both industry segments and geographical segments:
  - (a) sales or other operating revenues, distinguishing between revenue derived from customers outside the enterprise and revenue derived from other segments;
  - (b) segment result;
  - (c) segment assets employed; and
  - (d) the basis of inter-segment pricing.

For an enterprise's primary basis of segment reporting (business segments or geographical segments), IAS 14 (revised) requires those same four items of information plus:

- (a) segment liabilities;
- (b) cost of property, plant, equipment, and intangible assets acquired during the period;
- (c) depreciation and amortisation expense;
- (d) non-cash expenses other than depreciation and amortisation; and
- (e) the enterprise's share of the net profit or loss of an associate, joint venture, or other investment accounted for under the equity method if substantially all of the associate's operations are within only that segment, and the amount of the related investment.

For an enterprise's secondary basis of segment reporting, IAS 14 (revised) drops the original IAS 14 requirement for segment result and replaces it with the cost of property, plant, equipment, and intangible assets acquired during the period.

10. The original IAS 14 was silent on whether prior period segment information presented for comparative purposes should be restated for a material change in segment accounting policies. IAS 14 (revised) requires restatement unless it is impracticable to do so.
11. IAS 14 (revised) requires that if total revenue from external customers for all reportable segments combined is less than 75 % of total enterprise revenue, then additional reportable segments should be identified until the 75 % level is reached.
12. The original IAS 14 allowed a different method of pricing inter-segment transfers to be used in segment data than was actually used to price the transfers. IAS 14 (revised) requires that inter-segment transfers be measured on the basis that the enterprise actually used to price the transfers.
13. IAS 14 (revised) requires disclosure of revenue for any segment not deemed reportable because it earns a majority of its revenue from sales to other segments if that segment's revenue from sales to external customers is 10 % or more of total enterprise revenue. The original IAS 14 had no comparable requirement.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

## OBJECTIVE

The objective of this Standard is to establish principles for reporting financial information by segment — information about the different types of products and services an enterprise produces and the different geographical areas in which it operates — to help users of financial statements:

- (a) better understand the enterprise's past performance;
- (b) better assess the enterprise's risks and returns; and
- (c) make more informed judgements about the enterprise as a whole.

Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. Information about an enterprise's different types of products and services and its operations in different geographical areas — often called segment information — is relevant to assessing the risks and returns of a diversified or multinational enterprise but may not be determinable from the aggregated data. Therefore, segment information is widely regarded as necessary to meeting the needs of users of financial statements.

## SCOPE

1. ***This Standard should be applied in complete sets of published financial statements that comply with International Accounting Standards.***
2. A complete set of financial statements includes a balance sheet, income statement, cash flow statement, a statement showing changes in equity, and notes, as provided in IAS 1, presentation of financial statements.
3. ***This Standard should be applied by enterprises whose equity or debt securities are publicly traded and by enterprises that are in the process of issuing equity or debt securities in public securities markets.***
4. If an enterprise whose securities are not publicly traded prepares financial statements that comply with International Accounting Standards, that enterprise is encouraged to disclose financial information by segment voluntarily.
5. ***If an enterprise whose securities are not publicly traded chooses to disclose segment information voluntarily in financial statements that comply with International Accounting Standards, that enterprise should comply fully with the requirements of this Standard.***
6. ***If a single financial report contains both consolidated financial statements of an enterprise whose securities are publicly traded and the separate financial statements of the parent or one or more subsidiaries, segment information need be presented only on the basis of the consolidated financial statements. If a subsidiary is itself an enterprise whose securities are publicly traded, it will present segment information in its own separate financial report.***
7. ***Similarly, if a single financial report contains both the financial statements of an enterprise whose securities are publicly traded and the separate financial statements of an equity method associate or joint venture in which the enterprise has a financial interest, segment information need be presented only on the basis of the enterprise's financial statements. If the equity method associate or joint venture is itself an enterprise whose securities are publicly traded, it will present segment information in its own separate financial report.***

## DEFINITIONS

Definitions from other international accounting standards

8. ***The following terms are used in this Standard with the meanings specified in IAS 7, cash flow statements; IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies; and IAS 18, revenue:***

***Operating activities are the principal revenue-producing activities of an enterprise and other activities that are not investing or financing activities.***

***Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.***

***Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants.***

Definitions of business segment and geographical segment

9. ***The terms business segment and geographical segment are used in this Standard with the following meanings:***

***A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products and services are related include:***

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- (a) *the nature of the products or services;*
- (b) *the nature of the production processes;*
- (c) *the type or class of customer for the products or services;*
- (d) *the methods used to distribute the products or provide the services; and*
- (e) *if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.*

***A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:***

- (a) *similarity of economic and political conditions;*
- (b) *relationships between operations in different geographical areas;*
- (c) *proximity of operations;*
- (d) *special risks associated with operations in a particular area;*
- (e) *exchange control regulations; and*
- (f) *the underlying currency risks.*

***A reportable segment is a business segment or a geographical segment identified based on the foregoing definitions for which segment information is required to be disclosed by this Standard.***

- 10. The factors in paragraph 9 for identifying business segments and geographical segments are not listed in any particular order.
- 11. A single business segment does not include products and services with significantly differing risks and returns. While there may be dissimilarities with respect to one or several of the factors in the definition of a business segment, the products and services included in a single business segment are expected to be similar with respect to a majority of the factors.
- 12. Similarly, a geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country.
- 13. The predominant sources of risks affect how most enterprises are organised and managed. Therefore, paragraph 27 of this Standard provides that an enterprise's organisational structure and its internal financial reporting system is the basis for identifying its segments. The risks and returns of an enterprise are influenced both by the geographical location of its operations (where its products are produced or where its service delivery activities are based) and also by the location of its markets (where its products are sold or services are rendered). The definition allows geographical segments to be based on either:
  - (a) the location of an enterprise's production or service facilities and other assets; or
  - (b) the location of its markets and customers.
- 14. An enterprise's organisational and internal reporting structure will normally provide evidence of whether its dominant source of geographical risks results from the location of its assets (the origin of its sales) or the location of its customers (the destination of its sales). Accordingly, an enterprise looks to this structure to determine whether its geographical segments should be based on the location of its assets or on the location of its customers.

15. Determining the composition of a business or geographical segment involves a certain amount of judgement. In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in this Standard and the qualitative characteristics of financial statements as identified in the IASC framework for the preparation and presentation of financial statements. Those qualitative characteristics include the relevance, reliability, and comparability over time of financial information that is reported about an enterprise's different groups of products and services and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise as a whole.

*Definitions of segment revenue, expense, result, assets, and liabilities*

16. *The following additional terms are used in this Standard with the meanings specified:*

*Segment revenue is revenue reported in the enterprise's income statement that is directly attributable to a segment and the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, whether from sales to external customers or from transactions with other segments of the same enterprise. Segment revenue does not include:*

- (a) *extraordinary items;*
- (b) *interest or dividend income, including interest earned on advances or loans to other segments, unless the segment's operations are primarily of a financial nature; or*
- (c) *gains on sales of investments or gains on extinguishment of debt unless the segment's operations are primarily of a financial nature.*

*Segment revenue includes an enterprise's share of profits or losses of associates, joint ventures, or other investments accounted for under the equity method only if those items are included in consolidated or total enterprise revenue.*

*Segment revenue includes a joint venturer's share of the revenue of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IAS 31, financial reporting of interests in joint ventures.*

*Segment expense is expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the same enterprise. Segment expense does not include:*

- (a) *extraordinary items;*
- (b) *interest, including interest incurred on advances or loans from other segments, unless the segment's operations are primarily of a financial nature;*
- (c) *losses on sales of investments or losses on extinguishment of debt unless the segment's operations are primarily of a financial nature;*
- (d) *an enterprise's share of losses of associates, joint ventures, or other investments accounted for under the equity method;*
- (e) *income tax expense; or*
- (f) *general administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are segment expenses if they relate to the segment's operating activities and they can be directly attributed or allocated to the segment on a reasonable basis.*

*Segment expense includes a joint venturer's share of the expenses of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IAS 31.*

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*For a segment's operations that are primarily of a financial nature, interest income and interest expense may be reported as a single net amount for segment reporting purposes only if those items are netted in the consolidated or enterprise financial statements.*

*Segment result is segment revenue less segment expense. Segment result is determined before any adjustments for minority interest.*

*Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.*

*If a segment's segment result includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other income-producing assets.*

*Segment assets do not include income tax assets.*

*Segment assets include investments accounted for under the equity method only if the profit or loss from such investments is included in segment revenue. Segment assets include a joint venturer's share of the operating assets of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IAS 31.*

*Segment assets are determined after deducting related allowances that are reported as direct offsets in the enterprise's balance sheet.*

*Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.*

*If a segment's segment result includes interest expense, its segment liabilities include the related interest-bearing liabilities.*

*Segment liabilities include a joint venturer's share of the liabilities of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IAS 31.*

*Segment liabilities do not include income tax liabilities.*

*Segment accounting policies are the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or enterprise as well as those accounting policies that relate specifically to segment reporting.*

17. The definitions of segment revenue, segment expense, segment assets, and segment liabilities include amounts of such items that are directly attributable to a segment and amounts of such items that can be allocated to a segment on a reasonable basis. An enterprise looks to its internal financial reporting system as the starting point for identifying those items that can be directly attributed, or reasonably allocated, to segments. That is, there is a presumption that amounts that have been identified with segments for internal financial reporting purposes are directly attributable or reasonably allocable to segments for the purpose of measuring the segment revenue, segment expense, segment assets, and segment liabilities of reportable segments.
18. In some cases, however, a revenue, expense, asset, or liability may have been allocated to segments for internal financial reporting purposes on a basis that is understood by enterprise management but that could be deemed subjective, arbitrary, or difficult to understand by external users of financial statements. Such an allocation would not constitute a reasonable basis under the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Standard. Conversely, an enterprise may choose not to allocate some item of revenue, expense, asset, or liability for internal financial reporting purposes, even though a reasonable basis for doing so exists. Such an item is allocated pursuant to the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Standard.

19. Examples of segment assets include current assets that are used in the operating activities of the segment, property, plant, and equipment, assets that are the subject of finance leases (IAS 17, leases), and intangible assets. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general enterprise or head-office purposes. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists. Segment assets include goodwill that is directly attributable to a segment or that can be allocated to a segment on a reasonable basis, and segment expense includes related amortisation of goodwill.
20. Examples of segment liabilities include trade and other payables, accrued liabilities, customer advances, product warranty provisions, and other claims relating to the provision of goods and services. Segment liabilities do not include borrowings, liabilities related to assets that are the subject of finance leases (IAS 17), and other liabilities that are incurred for financing rather than operating purposes. If interest expense is included in segment result, the related interest-bearing liability is included in segment liabilities. The liabilities of segments whose operations are not primarily of a financial nature do not include borrowings and similar liabilities because segment result represents an operating, rather than a net-of-financing, profit or loss. Further, because debt is often issued at the head-office level on an enterprise-wide basis, it is often not possible to directly attribute, or reasonably allocate, the interest-bearing liability to the segment.
21. Measurements of segment assets and liabilities include adjustments to the prior carrying amounts of the identifiable segment assets and segment liabilities of a company acquired in a business combination accounted for as a purchase, even if those adjustments are made only for the purpose of preparing consolidated financial statements and are not recorded in either the parent's or the subsidiary's separate financial statements. Similarly, if property, plant, and equipment has been revalued subsequent to acquisition in accordance with the alternative accounting treatment allowed by IAS 16, then measurements of segment assets reflect those revaluations.
22. Some guidance for cost allocation can be found in other International Accounting Standards. For example, paragraphs 8 to 16 of IAS 2, inventories, provide guidance for attributing and allocating costs to inventories, and paragraphs 16 to 21 of IAS 11, construction contracts, provide guidance for attributing and allocating costs to contracts. That guidance may be useful in attributing or allocating costs to segments.
23. IAS 7, cash flow statements, provides guidance as to whether bank overdrafts should be included as a component of cash or should be reported as borrowings.
24. Segment revenue, segment expense, segment assets, and segment liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group enterprises within a single segment.
25. While the accounting policies used in preparing and presenting the financial statements of the enterprise as a whole are also the fundamental segment accounting policies, segment accounting policies include, in addition, policies that relate specifically to segment reporting, such as identification of segments, method of pricing inter-segment transfers, and basis for allocating revenues and expenses to segments.

#### IDENTIFYING REPORTABLE SEGMENTS

##### *Primary and secondary segment reporting formats*

26. ***The dominant source and nature of an enterprise's risks and returns should govern whether its primary segment reporting format will be business segments or geographical segments. If the enterprise's risks and rates of return are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business segments, with secondary information reported geographically. Similarly, if the enterprise's risks and rates of return are affected predominantly by the fact that it operates in different countries or other geographical areas, its primary format for reporting segment information should be geographical segments, with secondary information reported for groups of related products and services.***

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27. ***An enterprise's internal organisational and management structure and its system of internal financial reporting to the board of directors and the chief executive officer should normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the enterprise and, therefore, for determining which reporting format is primary and which is secondary, except as provided in subparagraphs (a) and (b) below:***
- (a) ***if an enterprise's risks and rates of return are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates, as evidenced by a 'matrix approach' to managing the company and to reporting internally to the board of directors and the chief executive officer, then the enterprise should use business segments as its primary segment reporting format and geographical segments as its secondary reporting format; and***
- (b) ***if an enterprise's internal organisational and management structure and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or on groups of related products/services nor on geography, the directors and management of the enterprise should determine whether the enterprise's risks and returns are related more to the products and services it produces or more to the geographical areas in which it operates and, as a consequence, should choose either business segments or geographical segments as the enterprise's primary segment reporting format, with the other as its secondary reporting format.***
28. For most enterprises, the predominant source of risks and returns determines how the enterprise is organised and managed. An enterprise's organisational and management structure and its internal financial reporting system normally provide the best evidence of the enterprise's predominant source of risks and returns for purpose of its segment reporting. Therefore, except in rare circumstances, an enterprise will report segment information in its financial statements on the same basis as it reports internally to top management. Its predominant source of risks and returns becomes its primary segment reporting format. Its secondary source of risks and returns becomes its secondary segment reporting format.
29. A 'matrix presentation' — both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis — often will provide useful information if an enterprise's risks and rates of return are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates. This Standard does not require, but does not prohibit, a 'matrix presentation'.
30. In some cases, an enterprise's organisation and internal reporting may have developed along lines unrelated either to differences in the types of products and services they produce or to the geographical areas in which they operate. For instance, internal reporting may be organised solely by legal entity, resulting in internal segments composed of groups of unrelated products and services. In those unusual cases, the internally reported segment data will not meet the objective of this Standard. Accordingly, paragraph 27(b) requires the directors and management of the enterprise to determine whether the enterprise's risks and returns are more product/service driven or geographically driven and to choose either business segments or geographical segments as the enterprise's primary basis of segment reporting. The objective is to achieve a reasonable degree of comparability with other enterprises, enhance understandability of the resulting information, and meet the expressed needs of investors, creditors, and others for information about product/service-related and geographically-related risks and returns.

*Business and geographical segments*

31. ***An enterprise's business and geographical segments for external reporting purposes should be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's past performance and for making decisions about future allocations of resources, except as provided in paragraph 32.***

32. ***If an enterprise's internal organisational and management structure and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or on groups of related products/services nor on geography, paragraph 27(b) requires that the directors and management of the enterprise should choose either business segments or geographical segments as the enterprise's primary segment reporting format based on their assessment of which reflects the primary source of the enterprise's risks and returns, with the other its secondary reporting format. In that case, the directors and management of the enterprise must determine its business segments and geographical segments for external reporting purposes based on the factors in the definitions in paragraph 9 of this Standard, rather than on the basis of its system of internal financial reporting to the board of directors and chief executive officer, consistent with the following:***
- (a) ***if one or more of the segments reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions in paragraph 9 but others are not, subparagraph (b) should be applied only to those internal segments that do not meet the definitions in paragraph 9 (that is, an internally reported segment that meets the definition should not be further segmented);***
  - (b) ***for those segments reported internally to the directors and management that do not satisfy the definitions in paragraph 9, management of the enterprise should look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions in paragraph 9; and***
  - (c) ***if such an internally reported lower-level segment meets the definition of business segment or geographical segment based on the factors in paragraph 9, the criteria in paragraphs 34 and 35 for identifying reportable segments should be applied to that segment.***
33. Under this Standard, most enterprises will identify their business and geographical segments as the organisational units for which information is reported to the board of directors (particularly the supervisory non-management directors, if any) and to the chief executive officer (the senior operating decision maker, which in some cases may be a group of several people) for the purpose of evaluating each unit's past performance and for making decisions about future allocations of resources. And even if an enterprise must apply paragraph 32 because its internal segments are not along product/service or geographical lines, it will look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines rather than construct segments solely for external reporting purposes. This approach of looking to an enterprise's organisational and management structure and its internal financial reporting system to identify the enterprise's business and geographical segments for external reporting purposes is sometimes called the 'management approach', and the organisational components for which information is reported internally are sometimes called 'operating segments'.

*Reportable segments*

34. ***Two or more internally reported business segments or geographical segments that are substantially similar may be combined as a single business segment or geographical segment. Two or more business segments or geographical segments are substantially similar only if:***
- (a) ***they exhibit similar long-term financial performance; and***
  - (b) ***they are similar in all of the factors in the appropriate definition in paragraph 9.***
35. ***A business segment or geographical segment should be identified as a reportable segment if a majority of its revenue is earned from sales to external customers and:***
- (a) ***its revenue from sales to external customers and from transactions with other segments is 10 % or more of the total revenue, external and internal, of all segments; or***

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- (b) *its segment result, whether profit or loss, is 10 % or more of the combined result of all segments in profit or the combined result of all segments in loss, whichever is the greater in absolute amount; or*
  - (c) *its assets are 10 % or more of the total assets of all segments.*
- 36. ***If an internally reported segment is below all of the thresholds of significance in paragraph 35:***
  - (a) *that segment may be designated as a reportable segment despite its size;*
  - (b) *if not designated as a reportable segment despite its size, that segment may be combined into a separately reportable segment with one or more other similar internally reported segment(s) that are also below all of the thresholds of significance in paragraph 35 (two or more business segments or geographical segments are similar if they share a majority of the factors in the appropriate definition in paragraph 9); and*
  - (c) *if that segment is not separately reported or combined, it should be included as an unallocated reconciling item.*
- 37. ***If total external revenue attributable to reportable segments constitutes less than 75 % of the total consolidated or enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 % thresholds in paragraph 35, until at least 75 % of total consolidated or enterprise revenue is included in reportable segments.***
- 38. The 10 % thresholds in this Standard are not intended to be a guide for determining materiality for any aspect of financial reporting other than identifying reportable business and geographical segments.
- 39. By limiting reportable segments to those that earn a majority of their revenue from sales to external customers, this Standard does not require that the different stages of vertically integrated operations be identified as separate business segments. However, in some industries, current practice is to report certain vertically integrated activities as separate business segments even if they do not generate significant external sales revenue. For instance, many international oil companies report their upstream activities (exploration and production) and their downstream activities (refining and marketing) as separate business segments even if most or all of the upstream product (crude petroleum) is transferred internally to the enterprise's refining operation.
- 40. This Standard encourages, but does not require, the voluntary reporting of vertically integrated activities as separate segments, with appropriate description including disclosure of the basis of pricing inter-segment transfers as required by paragraph 75.
- 41. ***If an enterprise's internal reporting system treats vertically integrated activities as separate segments and the enterprise does not choose to report them externally as business segments, the selling segment should be combined into the buying segment(s) in identifying externally reportable business segments unless there is no reasonable basis for doing so, in which case the selling segment would be included as an unallocated reconciling item.***
- 42. ***A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10 % thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer exceed the 10 % thresholds, if the management of the enterprise judges the segment to be of continuing significance.***
- 43. ***If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 % thresholds, prior period segment data that is presented for comparative purposes should be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 % thresholds in the prior period, unless it is impracticable to do so.***

## SEGMENT ACCOUNTING POLICIES

44. ***Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or enterprise.***
45. There is a presumption that the accounting policies that the directors and management of an enterprise have chosen to use, in preparing its consolidated or enterprise-wide financial statements, are those that the directors and management believe are the most appropriate for external reporting purposes. Since the purpose of segment information is to help users of financial statements better understand and make more informed judgements about the enterprise as a whole, this Standard requires the use, in preparing segment information, of the accounting policies that the directors and management have chosen. That does not mean, however, that the consolidated or enterprise accounting policies are to be applied to reportable segments as if the segments were separate stand-alone reporting entities. A detailed calculation done in applying a particular accounting policy at the enterprise-wide level may be allocated to segments if there is a reasonable basis for doing so. Pension calculations, for example, often are done for an enterprise as a whole, but the enterprise-wide figures may be allocated to segments based on salary and demographic data for the segments.
46. This Standard does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the consolidated or enterprise financial statements provided that (a) the information is reported internally to the board of directors and the chief executive officer for purposes of making decisions about allocating resources to the segment and assessing its performance and (b) the basis of measurement for this additional information is clearly described.
47. ***Assets that are jointly used by two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.***
48. The way in which asset, liability, revenue, and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of that segment. It is not possible or appropriate to specify a single basis of allocation that should be adopted by all enterprises. Nor is it appropriate to force allocation of enterprise asset, liability, revenue, and expense items that relate jointly to two or more segments, if the only basis for making those allocations is arbitrary or difficult to understand. At the same time, the definitions of segment revenue, segment expense, segment assets, and segment liabilities are interrelated, and the resulting allocations should be consistent. Therefore, jointly used assets are allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments. For example, an asset is included in segment assets if, and only if, the related depreciation or amortisation is deducted in measuring segment result.

## DISCLOSURE

49. Paragraphs 50 to 67 specify the disclosures required for reportable segments for an enterprise's primary segment reporting format. Paragraphs 68 to 72 identify the disclosures required for an enterprise's secondary reporting format. Enterprises are encouraged to present all of the primary-segment disclosures identified in paragraphs 50 to 67 for each reportable secondary segment, although paragraphs 68 to 72 require considerably less disclosure on the secondary basis. Paragraphs 74 to 83 address several other segment disclosure matters. Appendix B to this Standard illustrates application of these disclosure standards.

*Primary reporting format*

50. ***The disclosure requirements in paragraphs 51 to 67 should be applied to each reportable segment based on an enterprise's primary reporting format.***

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51. ***An enterprise should disclose segment revenue for each reportable segment. Segment revenue from sales to external customers and segment revenue from transactions with other segments should be separately reported.***
52. ***An enterprise should disclose segment result for each reportable segment.***
53. If an enterprise can compute segment net profit or loss or some other measure of segment profitability other than segment result without arbitrary allocations, reporting of such amount(s) is encouraged in addition to segment result, appropriately described. If that measure is prepared on a basis other than the accounting policies adopted for the consolidated or enterprise financial statements, the enterprise will include in its financial statements a clear description of the basis of measurement.
54. An example of a measure of segment performance above segment result on the income statement is gross margin on sales. Examples of measures of segment performance below segment result on the income statement are profit or loss from ordinary activities (either before or after income taxes) and net profit or loss.
55. ***An enterprise should disclose the total carrying amount of segment assets for each reportable segment.***
56. ***An enterprise should disclose segment liabilities for each reportable segment.***
57. ***An enterprise should disclose the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment, and intangible assets) for each reportable segment. While this sometimes is referred to as capital additions or capital expenditure, the measurement required by this principle should be on an accrual basis, not a cash basis.***
58. ***An enterprise should disclose the total amount of expense included in segment result for depreciation and amortisation of segment assets for the period for each reportable segment.***
59. ***An enterprise is encouraged, but not required to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of each reportable segment for the period.***
60. IAS 8 requires that 'when items of income or expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately'. IAS 8 offers a number of examples, including write-downs of inventories and property, plant, and equipment, provisions for restructurings, disposals of property, plant, and equipment and long-term investments, discontinued operations, litigation settlements, and reversals of provisions. Paragraph 59 is not intended to change the classification of any such items of revenue or expense from ordinary to extraordinary (as defined in IAS 8) or to change the measurement of such items. The disclosure encouraged by that paragraph, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the enterprise level to the segment level.
61. ***An enterprise should disclose, for each reportable segment, the total amount of significant non-cash expenses, other than depreciation and amortisation for which separate disclosure is required by paragraph 58, that were included in segment expense and, therefore, deducted in measuring segment result.***
62. IAS 7 requires that an enterprise present a cash flow statement that separately reports cash flows from operating, investing, and financing activities. IAS 7 notes that disclosing cash flow information for each reportable industry and geographical segment is relevant to understanding the enterprise's overall financial position, liquidity, and cash flows. IAS 7 encourages the disclosure of such information. This Standard also encourages the segment cash flow disclosures that are encouraged by IAS 7. Additionally, it encourages disclosure of significant non-cash revenues that were included in segment revenue and, therefore, added in measuring segment result.

63. ***An enterprise that provides the segment cash flow disclosures that are encouraged by IAS 7 need not also disclose depreciation and amortisation expense pursuant to paragraph 58 or non-cash expenses pursuant to paragraph 61.***
64. ***An enterprise should disclose, for each reportable segment, the aggregate of the enterprise's share of the net profit or loss of associates, joint ventures, or other investments accounted for under the equity method if substantially all of those associates' operations are within that single segment.***
65. While a single aggregate amount is disclosed pursuant to the preceding paragraph, each associate, joint venture, or other equity method investment is assessed individually to determine whether its operations are substantially all within a segment.
66. ***If an enterprise's aggregate share of the net profit or loss of associates, joint ventures, or other investments accounted for under the equity method is disclosed by reportable segment, the aggregate investments in those associates and joint ventures should also be disclosed by reportable segment.***
67. ***An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the consolidated or enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue from external customers (including disclosure of the amount of enterprise revenue from external customers not included in any segment's revenue); segment results should be reconciled to a comparable measure of enterprise operating profit or loss as well as to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities.***

*Secondary segment information*

68. Paragraphs 50 to 67 identify the disclosure requirements to be applied to each reportable segment based on an enterprise's primary reporting format. Paragraphs 69 to 72 identify the disclosure requirements to be applied to each reportable segment based on an enterprise's secondary reporting format, as follows:
- (a) if an enterprise's primary format is business segments, the required secondary-format disclosures are identified in paragraph 69;
- (b) if an enterprise's primary format is geographical segments based on location of assets (where the enterprise's products are produced or where its service delivery operations are based), the required secondary-format disclosures are identified in paragraphs 70 and 71;
- (c) if an enterprise's primary format is geographical segments based on the location of its customers (where its products are sold or services are rendered), the required secondary-format disclosures are identified in paragraphs 70 and 72.
69. ***If an enterprise's primary format for reporting segment information is business segments, it should also report the following information:***
- (a) ***segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 % or more of total enterprise revenue from sales to all external customers;***
- (b) ***the total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10 % or more of the total assets of all geographical segments; and***

**IAS 14**

- (c) *the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment, and intangible assets) by geographical location of assets, for each geographical segment whose segment assets are 10 % or more of the total assets of all geographical segments.*
70. *If an enterprise's primary format for reporting segment information is geographical segments (whether based on location of assets or location of customers), it should also report the following segment information for each business segment whose revenue from sales to external customers is 10 % or more of total enterprise revenue from sales to all external customers or whose segment assets are 10 % or more of the total assets of all business segments:*
- (a) *segment revenue from external customers;*
- (b) *the total carrying amount of segment assets; and*
- (c) *the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment, and intangible assets).*
71. *If an enterprise's primary format for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, then the enterprise should also report revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is 10 % or more of total enterprise revenue from sales to all external customers.*
72. *If an enterprise's primary format for reporting segment information is geographical segments that are based on location of customers, and if the enterprise's assets are located in different geographical areas from its customers, then the enterprise should also report the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are 10 % or more of related consolidated or total enterprise amounts:*
- (a) *the total carrying amount of segment assets by geographical location of the assets; and*
- (b) *the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment, and intangible assets) by location of the assets.*

*Illustrative segment disclosures*

73. Appendix B to this Standard presents an illustration of the disclosures for primary and secondary reporting formats that are required by this Standard.

*Other disclosure matters*

74. *If a business segment or geographical segment for which information is reported to the board of directors and chief executive officer is not a reportable segment because it earns a majority of its revenue from sales to other segments, but none the less its revenue from sales to external customers is 10 % or more of total enterprise revenue from sales to all external customers, the enterprise should disclose that fact and the amounts of revenue from (a) sales to external customers and (b) internal sales to other segments.*
75. *In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.*

76. ***Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed, and prior period segment information presented for comparative purposes should be restated unless it is impracticable to do so. Such disclosure should include a description of the nature of the change, the reasons for the change, the fact that comparative information has been restated or that it is impracticable to do so, and the financial effect of the change, if it is reasonably determinable. If an enterprise changes the identification of its segments and it does not restate prior period segment information on the new basis because it is impracticable to do so, then for the purpose of comparison the enterprise should report segment data for both the old and the new bases of segmentation in the year in which it changes the identification of its segments.***
77. Changes in accounting policies adopted by the enterprise are dealt with in IAS 8. IAS 8 requires that changes in accounting policy should be made only if required by statute, or by an accounting standard-setting body, or if the change will result in a more appropriate presentation of events or transactions in the financial statements of the enterprise.
78. Changes in accounting policies adopted at the enterprise level that affect segment information are dealt with in accordance with IAS 8. Unless a new International Accounting Standard specifies otherwise, IAS 8 requires that a change in accounting policy should be applied retrospectively and that prior period information be restated unless it is impracticable to do so (benchmark treatment) or that the cumulative adjustment resulting from the change be included in determining the enterprise's net profit or loss for the current period (allowed alternative treatment). If the benchmark treatment is followed, prior period segment information will be restated. If the allowed alternative is followed, the cumulative adjustment that is included in determining the enterprise's net profit or loss is included in segment result if it is an operating item that can be attributed or reasonably allocated to segments. In the latter case, IAS 8 may require separate disclosure if its size, nature, or incidence is such that the disclosure is relevant to explain the performance of the enterprise for the period.
79. Some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand the changes and to assess trends, prior period segment information that is included in the financial statements for comparative purposes is restated, if practicable, to reflect the new accounting policy.
80. Paragraph 75 requires that, for segment reporting purposes, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. If an enterprise changes the method that it actually uses to price inter-segment transfers, that is not a change in accounting policy for which prior period segment data should be restated pursuant to paragraph 76. However, paragraph 75 requires disclosure of the change.
81. ***An enterprise should indicate the types of products and services included in each reported business segment and indicate the composition of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements or elsewhere in the financial report.***
82. To assess the impact of such matters as shifts in demand, changes in the price of inputs or other factors of production, and the development of alternative products and processes on a business segment, it is necessary to know the activities encompassed by that segment. Similarly, to assess the impact of changes in the economic and political environment on the risks and rates of returns of a geographical segment, it is important to know the composition of that geographical segment.

**IAS 15**

83. Previously reported segments that no longer satisfy the quantitative thresholds are not reported separately. They may no longer satisfy those thresholds, for example, because of a decline in demand or a change in management strategy or because a part of the operations of the segment has been sold or combined with other segments. An explanation of the reasons why a previously reported segment is no longer reported may also be useful in confirming expectations regarding declining markets and changes in enterprise strategies.

## EFFECTIVE DATE

84. *This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 July 1998. Earlier application is encouraged. If an enterprise applies this Standard for financial statements covering periods beginning before 1 July 1998 instead of the original IAS 14, the enterprise should disclose that fact. If financial statements include comparative information for periods prior to the effective date or earlier voluntary adoption of this Standard, restatement of segment data included therein to conform to the provisions of this Standard is required unless it is not practicable to do so, in which case the enterprise should disclose that fact.*

**INTERNATIONAL ACCOUNTING STANDARD IAS 15  
(REFORMATTED 1994)**

**Information reflecting the effects of changing prices**

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in June 1981. It is presented in the revised format adopted for International Accounting Standards in 1991 onwards. No substantive changes have been made to the original approved text. Certain terminology has been changed to bring it into line with current IASC practice.

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## BOARD STATEMENT OCTOBER 1989

At its meeting in October 1989, the Board of IASC approved the following statement to be added to IAS 15, information reflecting the effects of changing prices:

## IAS 15

The international consensus on the disclosure of information reflecting the effects of changing prices that was anticipated when IAS 15 was issued has not been reached. As a result, the Board of IASC has decided that enterprises need not disclose the information required by IAS 15 in order that their financial statements conform with International Accounting Standards. However, the Board encourages enterprises to present such information and urges those that do to disclose the items required by IAS 15.

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

## SCOPE

1. ***This Standard should be applied in reflecting the effects of changing prices on the measurements used in the determination of an enterprise's results of operation and financial position.***
2. This International Accounting Standard supersedes IAS 6, accounting responses to changing prices.
3. This Standard applies to enterprises whose levels of revenues, profit, assets or employment are significant in the economic environment in which they operate. When both parent company and consolidated financial statements are presented, the information called for by this Standard need only be presented on the basis of consolidated information.
4. The information called for by this Standard is not required for a subsidiary operating in the country of domicile of its parent if consolidated information on this basis is presented by the parent. For subsidiaries operating in a country other than the country of domicile of the parent, the information called for by this Standard is only required when it is accepted practice for similar information to be presented by enterprises of economic significance in that country.
5. Presentation of information reflecting the effects of changing prices is encouraged for other entities in the interest of promoting more informative financial reporting.

## EXPLANATION

6. Prices change over time as the result of various specific or general economic and social forces. Specific forces such as changes in supply and demand and technological changes may cause individual prices to increase or decrease significantly and independently of each other. In addition, general forces may result in a change in the general level of prices and therefore in the general purchasing power of money.
7. In most countries financial statements are prepared on the historical cost basis of accounting without regard either to changes in the general level of prices or to changes in specific prices of assets held, except to the extent that property, plant and equipment may have been revalued or inventories or other current assets reduced to net realisable value. The information required by this Standard is designed to make users of an enterprise's financial statements aware of the effects of changing prices on the results of its operations. Financial statements, however, whether prepared under the historical cost method or under a method that reflects the effects of changing prices, are not intended to indicate directly the value of the enterprise as a whole.

## RESPONDING TO CHANGING PRICES

8. ***Enterprises to which this Standard applies should present information disclosing the items set out in paragraphs 21 to 23 using an accounting method reflecting the effects of changing prices.***

**IAS 15**

9. Financial information intended as a response to the effects of changing prices is prepared in a number of ways. One way shows financial information in terms of general purchasing power. Another way shows current cost in place of historical cost, recognising changes in specific prices of assets. A third way combines features of both these methods.
10. Underlying these responses are two basic approaches to the determination of income. One recognises income after the general purchasing power of the shareholders' equity in the enterprise has been maintained. The other recognises income after the operating capacity of the enterprise has been maintained, and may or may not include a general price level adjustment.

*General purchasing power approach*

11. The general purchasing power approach involves the restatement of some or all of the items in the financial statements for changes in the general price level. Proposals on this subject emphasise that general purchasing power restatements change the unit of account but do not change the underlying measurement bases. Under this approach, income normally reflects the effects, using an appropriate index, of general price level changes on depreciation, cost of sales and net monetary items and is reported after the general purchasing power of the shareholders' equity in the enterprise has been maintained.

*Current cost approach*

12. The current cost approach is found in a number of different methods. In general, these use replacement cost as the primary measurement basis. If, however, replacement cost is higher than both net realisable value and present value, the higher of net realisable value and present value is usually used as the measurement basis.
13. The replacement cost of a specific asset is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential. Net realisable value usually represents the net current selling price of the asset. Present value represents a current estimate of future net receipts attributable to the asset, appropriately discounted.
14. Specific price indices are often used as a means to determine current costs for items, particularly if no recent transaction involving those items has occurred, no price lists are available or the use of price lists is not practical.
15. Current cost methods generally require recognition of the effects on depreciation and cost of sales of changes in prices specific to the enterprise. Most such methods also require the application of some form of adjustments which have in common a general recognition of the interaction between changing prices and the financing of an enterprise. As discussed in paragraphs 16 to 18, opinions differ on the form these adjustments should take.
16. Some current cost methods require an adjustment reflecting the effects of changing prices on all net monetary items, including long-term liabilities, leading to a loss from holding net monetary assets or to a gain from having net monetary liabilities when prices are rising, and vice versa. Other methods limit this adjustment to the monetary assets and liabilities included in the working capital of the enterprise. Both types of adjustment recognise that not only non-monetary assets but also monetary items are important elements of the operating capacity of the enterprise. A normal feature of the current cost methods described above is that they recognise income after the operating capacity of the enterprise has been maintained.
17. Another view is that it is unnecessary to recognise in the income statement the additional replacement cost of assets to the extent that they are financed by borrowing. Methods based on this view report income after the portion of the enterprise's operating capacity that is financed by its shareholders has been maintained. This may be achieved, for example, by reducing the total of the adjustment for depreciation, cost of sales, and, where the method requires it, monetary working capital, in the proportion that finance by borrowing bears to finance by the total of borrowing and equity capital.

18. Some current cost methods apply a general price level index to the amount of shareholders' interests. This indicates the extent to which shareholders' equity in the enterprise has been maintained in terms of the general purchasing power when the increase in the replacement cost of the assets arising during the period is less than the decrease in the purchasing power of the shareholders' interests during the same period. Sometimes this calculation is merely noted to enable a comparison to be made between net assets in terms of general purchasing power and net assets in terms of current costs. Under other methods, which recognise income after the general purchasing power of shareholders' equity in the enterprise has been maintained, the difference between the two net assets figures is treated as a gain or loss accruing to the shareholders.

*Current status*

19. While financial information is sometimes provided using the various methods for reflecting the changing prices described above, either in primary or supplementary financial statements, there is not yet an international consensus on the subject. Consequently, the International Accounting Standards Committee believes that further experimentation is necessary before consideration can be given to requiring enterprises to prepare primary financial statements using a comprehensive and uniform system for reflecting changing prices. Meanwhile, evolution of the subject would be assisted if enterprises that present primary financial statements on the historical cost basis also provide supplementary information reflecting the effects of price changes.
20. There is a variety of proposals as to the items to be included in such information, ranging from a few income statement items to extensive income statement and balance sheet disclosures. It is desirable that there be an internationally established minimum of items to be included in the information.

MINIMUM DISCLOSURES

21. ***The items to be presented are:***
- (a) ***the amount of the adjustment to or the adjusted amount of depreciation of property, plant and equipment;***
  - (b) ***the amount of the adjustment to or the adjusted amount of cost of sales;***
  - (c) ***the adjustments relating to monetary items, the effect of borrowing, or equity interests when such adjustments have been taken into account in determining income under the accounting method adopted; and***
  - (d) ***the overall effect on results of the adjustments described in (a) and (b) and, where appropriate, (c), as well as any other items reflecting the effects of changing prices that are reported under the accounting method adopted.***
22. ***When a current cost method is adopted the current cost of property, plant and equipment, and of inventories, should be disclosed.***
23. ***Enterprises should describe the methods adopted to compute the information called for in paragraphs 21 and 22, including the nature of any indices used.***
24. ***The information required by paragraphs 21 to 23 should be provided on a supplementary basis unless such information is presented in the primary financial statements.***
25. In most countries, such information is supplementary to, but not a part of, the primary financial statements. This Standard does not apply to the accounting and reporting policies required to be used by an enterprise in the preparation of its primary financial statements, unless those financial statements are presented on a basis that reflects the effects of changing prices.

**IAS 16**

## OTHER DISCLOSURES

26. Enterprises are encouraged to provide additional disclosures, and in particular a discussion of the significance of the information in the circumstances of the enterprise. Disclosure of any adjustments to tax provisions or tax balances is usually helpful.

## EFFECTIVE DATE

27. ***This International Accounting Standard supersedes IAS 6, accounting responses to changing prices, and becomes operative for financial statements covering periods beginning on or after 1 January 1983.***

**INTERNATIONAL ACCOUNTING STANDARD IAS 16  
(REVISED 1998)**

**Property, plant and equipment**

IAS 16, accounting for property, plant and equipment, was approved in March 1982.

In December 1993, IAS 16 was revised as part of the project on Comparability and improvements of financial statements. It became IAS 16, property, plant and equipment (IAS 16 (revised 1993)).

In July 1997, when IAS 1, presentation of financial statements, was approved, paragraph 66(e) of IAS 16 (revised 1993) (now paragraph 60(e) of this Standard) was amended.

In April and July 1998, various paragraphs of IAS 16 (revised 1993) were revised to be consistent with IAS 22 (revised 1998), business combinations, IAS 36, impairment of assets, and IAS 37, provisions, contingent liabilities and contingent assets. The revised Standard (IAS 16 (revised 1998)) became operative for annual financial statements covering periods beginning on or after 1 July 1999.

In April 2000, paragraph 4 was amended by IAS 40, investment property. IAS 40 became operative for annual financial statements covering periods beginning on or after 1 January 2001.

In January 2001, paragraph 2 was amended by IAS 41, Agriculture. IAS 41 is operative for annual financial statements covering periods beginning on or after 1 January 2003.

The following SIC interpretations relate to IAS 16:

- SIC-14: property, plant and equipment — compensation for the impairment or loss of items.
- SIC-23: property, plant and equipment — major inspection or overhaul costs.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

**OBJECTIVE**

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them.

This Standard requires an item of property, plant and equipment to be recognised as an asset when it satisfies the definition and recognition criteria for an asset in the framework for the preparation and presentation of financial statements.

**SCOPE**

1. ***This Standard should be applied in accounting for property, plant and equipment except when another International Accounting Standard requires or permits a different accounting treatment.***
2. This Standard does not apply to:
  - (a) biological assets related to agricultural activity (see IAS 41, agriculture); and
  - (b) mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard does apply to property, plant and equipment used to develop or maintain the activities or assets covered in (a) or (b) but separable from those activities or assets.

3. In some circumstances International Accounting Standards permit the initial recognition of the carrying amount of property, plant and equipment to be determined using an approach different from that prescribed in this Standard. For example, IAS 22 (revised 1998), business combinations, requires property, plant and equipment acquired in a business combination to be measured initially at fair value even when it exceeds cost. However, in such cases all other aspects of the accounting treatment for these assets, including depreciation, are determined by the requirements of this Standard.

**IAS 16**

4. An enterprise applies IAS 40, investment property, rather than this Standard to its investment property. An enterprise applies this Standard to property being constructed or developed for future use as investment property. Once the construction or development is complete, the enterprise applies IAS 40. IAS 40 also applies to existing investment property that is being redeveloped for continued future use as investment property.
5. This Standard does not deal with certain aspects of the application of a comprehensive system reflecting the effects of changing prices (see IAS 15, information reflecting the effects of changing prices, and IAS 29, financial reporting in hyperinflationary economies). However, enterprises applying such a system are required to comply with all aspects of this Standard, except for those that deal with the measurement of property, plant and equipment subsequent to its initial recognition.

## DEFINITIONS

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

**Property, plant and equipment are tangible assets that:**

- (a) **are held by an enterprise 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.**

**Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.**

**Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.**

**Useful life is either:**

- (a) **the period of time over which an asset is expected to be used by the enterprise; or**
- (b) **the number of production or similar units expected to be obtained from the asset by the enterprise.**

**Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.**

**Residual value is the net amount which the enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.**

**Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.**

**An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.**

**Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation and accumulated impairment losses thereon.**

## RECOGNITION OF PROPERTY, PLANT AND EQUIPMENT

7. **An item of property, plant and equipment should be recognised as an asset when:**
  - (a) **it is probable that future economic benefits associated with the asset will flow to the enterprise; and**
  - (b) **the cost of the asset to the enterprise can be measured reliably.**
8. Property, plant and equipment is often a major portion of the total assets of an enterprise, and therefore is significant in the presentation of its financial position. Furthermore, the determination of whether an expenditure represents an asset or an expense can have a significant effect on an enterprise's reported results of operations.

9. In determining whether an item satisfies the first criterion for recognition, an enterprise needs to assess the degree of certainty attaching to the flow of future economic benefits on the basis of the available evidence at the time of initial recognition. Existence of sufficient certainty that the future economic benefits will flow to the enterprise necessitates an assurance that the enterprise will receive the rewards attaching to the asset and will undertake the associated risks. This assurance is usually only available when the risks and rewards have passed to the enterprise. Before this occurs, the transaction to acquire the asset can usually be cancelled without significant penalty and, therefore, the asset is not recognised.
10. The second criterion for recognition is usually readily satisfied because the exchange transaction evidencing the purchase of the asset identifies its cost. In the case of a self-constructed asset, a reliable measurement of the cost can be made from the transactions with parties external to the enterprise for the acquisition of the materials, labour and other inputs used during the construction process.
11. In identifying what constitutes a separate item of property, plant and equipment, judgement is required in applying the criteria in the definition to specific circumstances or specific types of enterprises. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value. Most spare parts and servicing equipment are usually carried as inventory and recognised as an expense as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when the enterprise 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 and their use is expected to be irregular, they are accounted for as property, plant and equipment and are depreciated over a time period not exceeding the useful life of the related asset.
12. In certain circumstances, it is appropriate to allocate the total expenditure on an asset to its component parts and account for each component separately. This is the case when the component assets have different useful lives or provide benefits to the enterprise in a different pattern thus necessitating use of different depreciation rates and methods. For example, an aircraft and its engines need to be treated as separate depreciable assets if they have different useful lives.
13. Property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, while not directly increasing the future economic benefits of any particular existing item of property, plant and equipment may be necessary in order for the enterprise to obtain the future economic benefits from its other assets. When this is the case, such acquisitions of property, plant and equipment qualify for recognition as assets, in that they enable future economic benefits from related assets to be derived by the enterprise in excess of what it could derive if they had not been acquired. However, such assets are only recognised to the extent that the resulting carrying amount of such an asset and related assets does not exceed the total recoverable amount of that asset and its related assets. For example, a chemical manufacturer may have to install certain new chemical handling processes in order to comply with environmental requirements on the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset to the extent they are recoverable because, without them, the enterprise is unable to manufacture and sell chemicals.

#### INITIAL MEASUREMENT OF PROPERTY, PLANT AND EQUIPMENT

14. ***An item of property, plant and equipment which qualifies for recognition as an asset should initially be measured at its cost.***

#### *Components of cost*

15. The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs are:
  - (a) the cost of site preparation;
  - (b) initial delivery and handling costs;

**IAS 16**

- (c) installation costs;
  - (d) professional fees such as for architects and engineers; and
  - (e) the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision under IAS 37, provisions, contingent liabilities and contingent assets.
16. When payment for an item of property, plant and equipment is deferred beyond normal credit terms, its cost is the cash price equivalent; the difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with the allowed alternative treatment in IAS 23, borrowing costs.
17. Administration and other general overhead costs are not a component of the cost of property, plant and equipment unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start-up and similar pre-production costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition. Initial operating losses incurred prior to an asset achieving planned performance are recognised as an expense.
18. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an enterprise makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of producing the assets for sale (see IAS 2, inventories). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in the production of a self-constructed asset is not included in the cost of the asset. IAS 23 establishes criteria which need to be satisfied before interest costs can be recognised as a component of property, plant and equipment cost.
19. The cost of an asset held by a lessee under a finance lease is determined using the principles set out in IAS 17, leases.
20. The carrying amount of property, plant and equipment may be reduced by applicable government grants in accordance with IAS 20, accounting for government grants and disclosure of government assistance.

*Exchanges of assets*

21. An item of property, plant and equipment may be acquired in exchange or part exchange for a dissimilar item of property, plant and equipment or other asset. The cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up adjusted by the amount of any cash or cash equivalents transferred.
22. An item of property, plant and equipment may be acquired in exchange for a similar asset that has a similar use in the same line of business and which has a similar fair value. An item of property, plant and equipment may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earnings process is incomplete, no gain or loss is recognised on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up. However, the fair value of the asset received may provide evidence of an impairment in the asset given up. Under these circumstances the asset given up is written down and this written down value assigned to the new asset. Examples of exchanges of similar assets include the exchange of aircraft, hotels, service stations and other real estate properties. If other assets such as cash are included as part of the exchange transaction this may indicate that the items exchanged do not have a similar value.

## SUBSEQUENT EXPENDITURE

23. ***Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised should be added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the enterprise. All other subsequent expenditure should be recognised as an expense in the period in which it is incurred.***

24. Subsequent expenditure on property, plant and equipment is only recognised as an asset when the expenditure improves the condition of the asset beyond its originally assessed standard of performance. Examples of improvements which result in increased future economic benefits include:
- (a) modification of an item of plant to extend its useful life, including an increase in its capacity;
  - (b) upgrading machine parts to achieve a substantial improvement in the quality of output; and
  - (c) adoption of new production processes enabling a substantial reduction in previously assessed operating costs.
25. Expenditure on repairs or maintenance of property, plant and equipment is made to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the asset. As such, it is usually recognised as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.
26. The appropriate accounting treatment for expenditure incurred subsequent to the acquisition of an item of property, plant and equipment depends on the circumstances which were taken into account on the initial measurement and recognition of the related item of property, plant and equipment and whether the subsequent expenditure is recoverable. For instance, when the carrying amount of the item of property, plant and equipment already takes into account a loss in economic benefits, the subsequent expenditure to restore the future economic benefits expected from the asset is capitalised provided that the carrying amount does not exceed the recoverable amount of the asset. This is also the case when the purchase price of an asset already reflects the enterprise's obligation to incur expenditure in the future which is necessary to bring the asset to its working condition. An example of this might be the acquisition of a building requiring renovation. In such circumstances, the subsequent expenditure is added to the carrying amount of the asset to the extent that it can be recovered from future use of the asset.
27. Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph 7 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the replaced asset is written off.

#### MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

##### *Benchmark treatment*

28. ***Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.***

##### *Allowed alternative treatment*

29. ***Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.***

#### Revaluations

30. The fair value of land and buildings is usually its market value. This value is determined by appraisal normally undertaken by professionally qualified valuers.

**IAS 16**

31. The fair value of items of plant and equipment is usually their market value determined by appraisal. When there is no evidence of market value because of the specialised nature of the plant and equipment and because these items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost.
32. The frequency of revaluations depends upon the movements in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment may experience significant and volatile movements in fair value thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant movements in fair value. Instead, revaluation every three or five years may be sufficient.
33. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is either:
- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of an index to its depreciated replacement cost; or
  - (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. For example, this method is used for buildings which are revalued to their market value.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount which is dealt with in accordance with paragraphs 37 and 38.

34. ***When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.***
35. A class of property, plant and equipment is a grouping of assets of a similar nature and use in an enterprise's operations. The following are examples of separate classes:
- (a) land;
  - (b) land and buildings;
  - (c) machinery;
  - (d) ships;
  - (e) aircraft;
  - (f) motor vehicles;
  - (g) furniture and fixtures; and
  - (h) office equipment.

36. The items within a class of property, plant and equipment are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements which are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period of time and provided the revaluations are kept up to date.
37. ***When an asset's carrying amount is increased as a result of a revaluation, the increase should be credited directly to equity under the heading of revaluation surplus. However, a revaluation increase should be recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense.***

38. ***When an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognised as an expense. However, a revaluation decrease should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset.***
39. The revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the enterprise; in such a case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. The transfer from revaluation surplus to retained earnings is not made through the income statement.
40. The effects on taxes on income, if any, resulting from the revaluation of property, plant and equipment are dealt with in IAS 12, income taxes.

#### DEPRECIATION

41. ***The depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life. The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. The depreciation charge for each period should be recognised as an expense unless it is included in the carrying amount of another asset.***
42. As the economic benefits embodied in an asset are consumed by the enterprise, the carrying amount of the asset is reduced to reflect this consumption, normally by charging an expense for depreciation. A depreciation charge is made even if the value of the asset exceeds its carrying amount.
43. The economic benefits embodied in an item of property, plant and equipment are consumed by the enterprise principally through the use of the asset. However, other factors such as technical obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits that might have been expected to be available from the asset. Consequently, all the following factors need to be considered in determining the useful life of an asset:
- (a) the expected usage of the asset by the enterprise. Usage is assessed by reference to the asset's expected capacity or physical output;
  - (b) the 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 of the enterprise, and the care and maintenance of the asset while idle;
  - (c) technical 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; and
  - (d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.
44. The useful life of an asset is defined in terms of the asset's expected utility to the enterprise. The asset management policy of an enterprise may involve the disposal of assets after a specified time or after consumption of a certain proportion of the economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of an item of property, plant and equipment is a matter of judgement based on the experience of the enterprise with similar assets.
45. Land and buildings are separable assets and are dealt with separately for accounting purposes, even when they are acquired together. Land normally has an unlimited life and, therefore, is not depreciated. Buildings have a limited life and, therefore, are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the useful life of the building.

**IAS 16**

46. The depreciable amount of an asset is determined after deducting the residual value of the asset. In practice, the residual value of an asset is often insignificant and therefore is immaterial in the calculation of the depreciable amount. When the benchmark treatment is adopted and the residual value is likely to be significant, the residual value is estimated at the date of acquisition and is not subsequently increased for changes in prices. However, when the allowed alternative treatment is adopted, a new estimate is made at the date of any subsequent revaluation of the asset. The estimate is based on the residual value prevailing at the date of the estimate for similar assets which have reached the end of their useful lives and which have operated under conditions similar to those in which the asset will be used.
47. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the sum-of-the-units method. Straight-line depreciation results in a constant charge over the useful life of the asset. The diminishing balance method results in a decreasing charge over the useful life of the asset. The sum-of-the-units method results in a charge based on the expected use or output of the asset. The method used for an asset is selected based on the expected pattern of economic benefits and is consistently applied from period to period unless there is a change in the expected pattern of economic benefits from that asset.
48. The depreciation charge for a period is usually recognised as an expense. However, in some circumstances, the economic benefits embodied in an asset are absorbed by the enterprise in producing other assets rather than giving rise to an expense. In this case, the depreciation charge comprises part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see IAS 2, inventories). Similarly, depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset that is recognised under IAS 38, intangible assets.

## Review of Useful Life

49. ***The useful life of an item of property, plant and equipment should be reviewed periodically and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods should be adjusted.***
50. During the life of an asset it may become apparent that the estimate of the useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure on the asset which improves the condition of the asset beyond its originally assessed standard of performance. Alternatively, technological changes or changes in the market for the products may reduce the useful life of the asset. In such cases, the useful life and, therefore, the depreciation rate is adjusted for the current and future periods.
51. The repair and maintenance policy of the enterprise may also affect the useful life of an asset. The policy may result in an extension of the useful life of the asset or an increase in its residual value. However, the adoption of such a policy does not negate the need to charge depreciation.

## Review of depreciation method

52. ***The depreciation method applied to property, plant and equipment should be reviewed periodically and, if there has been a significant change in the expected pattern of economic benefits from those assets, the method should be changed to reflect the changed pattern. When such a change in depreciation method is necessary the change should be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.***

## RECOVERABILITY OF THE CARRYING AMOUNT — IMPAIRMENT LOSSES

53. To determine whether an item of property, plant and equipment is impaired, an enterprise applies IAS 36, impairment of assets. That Standard explains how an enterprise 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<sup>(1)</sup>.

<sup>(1)</sup> See also SIC-14: property, plant and equipment — compensation for the impairment or loss of items.

54. IAS 22, business combinations, explains how to deal with an impairment loss recognised before the end of the first annual accounting period commencing after a business combination that is an acquisition.

#### RETIREMENTS AND DISPOSALS

55. ***An item of property, plant and equipment should be eliminated from the balance sheet on disposal or when the asset is permanently withdrawn from use and no future economic benefits are expected from its disposal.***
56. ***Gains or losses arising from the retirement or disposal of an item of property, plant and equipment should be determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.***
57. When an item of property, plant and equipment is exchanged for a similar asset, under the circumstances described in paragraph 22, the cost of the acquired asset is equal to the carrying amount of the asset disposed of and no gain or loss results.
58. Sale and leaseback transactions are accounted for in accordance with IAS 17, leases.
59. Property, plant and equipment that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under IAS 36, impairment of Assets, and recognises any impairment loss accordingly.

#### DISCLOSURE

60. ***The financial statements should disclose, for each class of property, plant and equipment:***
- (a) ***the measurement bases used for determining the gross carrying amount. When more than one basis has been used, the gross carrying amount for that basis in each category should be disclosed;***
  - (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 period;***
  - (e) ***a reconciliation of the carrying amount at the beginning and end of the period showing:***
    - (i) ***additions;***
    - (ii) ***disposals;***
    - (iii) ***acquisitions through business combinations;***
    - (iv) ***increases or decreases during the period resulting from revaluations under paragraphs 29, 37 and 38 and from impairment losses recognised or reversed directly in equity under IAS 36, impairment of assets (if any);***
    - (v) ***impairment losses recognised in the income statement during the period under IAS 36 (if any);***
    - (vi) ***impairment losses reversed in the income statement during the period under IAS 36 (if any);***
    - (vii) ***depreciation;***
    - (viii) ***the net exchange differences arising on the translation of the financial statements of a foreign entity; and***
    - (ix) ***other movements.***

## IAS 16

*Comparative information is not required for the reconciliation in (e).*

61. **The financial statements should also disclose:**
- (a) **the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;**
  - (b) **the accounting policy for the estimated costs of restoring the site of items of property, plant or equipment;**
  - (c) **the amount of expenditure on account of property, plant and equipment in the course of construction; and**
  - (d) **the amount of commitments for the acquisition of property, plant and equipment.**
62. The selection of the depreciation method and the estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information which allows them to review the policies selected by management and enables comparisons to be made with other enterprises. For similar reasons, it is necessary to disclose the depreciation allocated in a period and the accumulated depreciation at the end of that period.
63. An enterprise discloses the nature and effect of a change in an accounting estimate that has a material effect in the current period or which is expected to have a material effect in subsequent periods in accordance with IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policy. Such disclosure may arise from changes in estimate with respect to:
- (a) residual values;
  - (b) the estimated costs of dismantling and removing items of property, plant or equipment and restoring the site;
  - (c) useful lives; and
  - (d) depreciation method.
64. **When items of property, plant and equipment are stated at revalued amounts the following should be disclosed:**
- (a) **the basis used to revalue the assets;**
  - (b) **the effective date of the revaluation;**
  - (c) **whether an independent valuer was involved;**
  - (d) **the nature of any indices used to determine replacement cost;**
  - (e) **the carrying amount of each class of property, plant and equipment that would have been included in the financial statements had the assets been carried under the benchmark treatment in paragraph 28; and**
  - (f) **the revaluation surplus, indicating the movement for the period and any restrictions on the distribution of the balance to shareholders.**
65. An enterprise discloses information on impaired property, plant and equipment under IAS 36, impairment of assets, in addition to the information required by paragraph 60(e)(iv) to (vi).
66. Financial statement users also find the following information relevant to their needs:
- (a) the carrying amount of temporarily idle property, plant and equipment;
  - (b) the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;
  - (c) the carrying amount of property, plant and equipment retired from active use and held for disposal; and
  - (d) when the benchmark treatment is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, enterprises are encouraged to disclose these amounts.

## EFFECTIVE DATE

67. ***This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 1999. Earlier application is encouraged. If an enterprise applies this Standard for annual financial statements covering periods beginning before 1 July 1999, the enterprise should:***
- (a) ***disclose that fact; and***
  - (b) ***adopt IAS 22 (revised 1998), business combinations, IAS 36, impairment of assets, and IAS 37, provisions, contingent liabilities and contingent assets, at the same time.***
68. This Standard supersedes IAS 16, property, plant and equipment, approved in 1993.

**INTERNATIONAL ACCOUNTING STANDARD IAS 17  
(REVISED 1997)**

**Leases**

This revised International Accounting Standard supersedes IAS 17, accounting for leases, which was approved by the Board in a reformatted version in 1994. The revised Standard became operative for financial statements covering periods beginning on or after 1 January 1999.

In April 2000, paragraphs 1, 19, 24, 45 and 48 were amended, and paragraph 48A inserted by IAS 40, investment property. IAS 40 is effective for annual financial statements covering periods beginning on or after 1 January 2001.

In January 2001, paragraphs 1, 24 and 48A were amended by IAS 41, agriculture. IAS 41 is effective for annual financial statements covering periods beginning on or after 1 January 2003.

The following SIC interpretations relate to IAS 17:

- SIC-15: operating leases — incentives,
- SIC-27: evaluating the substance of transactions in the legal form of a lease.

## INTRODUCTION

This Standard ('IAS 17 (revised)') replaces IAS 17, accounting for leases ('the original IAS 17'). IAS 17 (revised) is effective for accounting periods beginning on or after 1 January 1999.

This Standard sets out improvements over the original IAS 17 it replaces based on a review conducted in the context of the limited revision that identified changes considered essential to complete a core set of standards acceptable for cross-border funding and stock-exchange listing. The IASC Board has agreed to undertake a more fundamental reform in the area of lease accounting standards.

The major changes from the original IAS 17 are as follows:

1. The original IAS 17 defined a lease as an arrangement whereby the lessor conveys the right to use an asset in return for rent payable by a lessee. IAS 17 (revised) modifies the definition by substituting the term 'rent' with 'a payment or series of payments'.

**IAS 17**

2. In stipulating that the classification of leases should be based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or lessee, justified by the application of the principle of substance over form, the original IAS 17 provided examples of situations as indicators that a lease is a finance lease. IAS 17 (revised) has added additional classification indicators to further facilitate the classification process.
3. The original IAS 17 used the term 'useful life' in the examples referred in the above for purposes of comparison to the lease term in the classification process. IAS 17 (revised) uses the term 'economic life', taking into account that an asset might be used by one or more users.
4. The original IAS 17 required the disclosure of contingent rents but was silent as to whether contingent rents should be included or excluded in the computation of minimum lease payments. IAS 17 (revised) requires that contingent rents be excluded from minimum lease payments.
5. The original IAS 17 was silent on the accounting treatment of initial direct costs incurred by a lessee in negotiating and securing leasing arrangements. IAS 17 provides guidance by requiring costs that are directly attributable to activities performed by a lessee for securing a finance lease, to be included in the amount of the leased asset.
6. The original IAS 17 provided a free choice of method in the allocation of finance income by a lessor, namely the recognition of income basing on a pattern reflecting a constant periodic rate of return based on either:
  - (a) the lessor's net investment outstanding in respect of the finance lease; or
  - (b) the lessor's net cash investment outstanding in respect of the finance lease.

IAS 17 (revised) requires that the recognition of finance income should be based reflecting a constant periodic rate of return basing on one method, namely the lessor's net investment outstanding in respect of the finance lease.

7. IAS 17 (revised) draws reference to the International Accounting Standard dealing with impairment of assets in providing guidance on the need to assess the possibility of an impairment of assets. The original IAS 17 did not address the matter.
8. IAS 17 (revised) mandates enhanced disclosures by both lessees and lessors for operating and finance leases through black letter lettering in comparison to the disclosure items required under the original IAS 17.

New disclosures required by IAS 17 (revised) include:

- (a) the total of minimum lease payments reconciled to the present values of lease liabilities in three periodic bands: not later than one year; later than one year and not later than five years; and later than five years (required of a lessee);
- (b) the total gross investment in the lease reconciled to the present value of minimum lease payments receivable in three periodic bands: not later than one year; later than one year and not later than five years; and later than five years (required of a lessor);
- (c) the related finance charges in (a) and (b) above;
- (d) the future minimum sublease payments expected to be received under non-cancellable subleases at balance sheet date;
- (e) the accumulated allowance for uncollectible minimum lease payments receivable; and
- (f) contingent rents recognised in income by lessors.

## IAS 17

9. The original IAS 17 included Appendices 1 to 3 which represented examples of situations in which a lease would normally be classified as a finance lease. The appendices have been omitted in IAS 17 (revised) in the light of the additional indicators included therein to further clarify the lease classification process.
10. It is noted that the provisions relating to the sale and leaseback transactions, in particular, the requirements involving a leaseback that is an operating lease, contain rules that prescribe a wide range of circumstances, based on relative amounts of fair value, carrying amount and selling price. IAS 17 (revised) includes an appendix as further guidance in interpreting the requirements.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

## OBJECTIVE

The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to finance and operating leases.

## SCOPE

1. ***This Standard should be applied in accounting for all leases other than:***
  - (a) ***lease agreements to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and***
  - (b) ***licensing agreements for such items as motion picture, video recordings, plays, manuscripts, patents and copyrights.***

## IAS 17

*However, this Standard should not be applied to the measurement by:*

- (a) *lessees of investment property held under finance leases (See IAS 40, investment property);*
  - (b) *lessors of investment property leased out under operating leases (see IAS 40, investment property);*
  - (c) *lessees of biological assets held under finance leases (see IAS 41, agriculture); or*
  - (d) *lessors of biological assets leased out under operating leases (see IAS 41, agriculture).*
2. This Standard 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. On the other hand, this Standard 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.

## DEFINITIONS

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

*A lease is 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.*

*A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.*

*An operating lease is a lease other than a finance lease.*

*A non-cancellable lease is a lease that is cancellable only:*

- (a) *upon the occurrence of some remote contingency;*
- (b) *with the permission of the lessor;*
- (c) *if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or*
- (d) *upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.*

*The inception of the lease is the earlier of the date of the lease agreement or of a commitment by the parties to the principal provisions of the lease.*

*The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.*

*Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:*

- (a) *in the case of the lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or*

(b) *in the case of the lessor, any residual value guaranteed to the lessor by either:*

- (i) *the lessee;*
- (ii) *a party related to the lessee; or*
- (iii) *an independent third party financially capable of meeting this guarantee.*

*However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise the minimum payments payable over the lease term and the payment required to exercise this purchase option.*

*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.*

*Economic life is either:*

- (a) *the period over which an asset is expected to be economically usable by one or more users; or*
- (b) *the number of production or similar units expected to be obtained from the asset by one or more users.*

*Useful life is the estimated remaining period, from the beginning of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the enterprise.*

*Guaranteed residual value is:*

- (a) *in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and*
- (b) *in the case of the lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging the obligations under the guarantee.*

*Unguaranteed residual value is that portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.*

*Gross investment in the lease is the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.*

*Unearned finance income is the difference between:*

- (a) *the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor; and*
- (b) *the present value of (a), at the interest rate implicit in the lease.*

*Net investment in the lease is the gross investment in the lease less unearned finance income.*

*The interest rate implicit in the lease is 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 fair value of the leased asset.*

*The lessee's incremental borrowing rate of interest is 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.*

## IAS 17

***Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).***

4. The definition of a lease includes contracts for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfilment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

## CLASSIFICATION OF LEASES

5. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.
6. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.
7. Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by lessor and lessee.
8. 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 <sup>(1)</sup>. Examples of situations which 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 which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
  - (c) the lease term is for the major part of the economic life of the asset even if title is not transferred;
  - (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
  - (e) the leased assets are of a specialised nature such that only the lessee can use them without major modifications being made.
9. Indicators of situations which 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 fair value of the residual fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
  - (c) the lessee has the ability to continue the lease for a secondary period at a rent which is substantially lower than market rent.

<sup>(1)</sup> See also SIC-27: evaluating the substance of transactions in the legal form of a lease.

10. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 5 to 9 had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.
11. Leases of land and buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee does not receive substantially all of the risks and rewards incident to ownership. A premium paid for such a leasehold represents pre-paid lease payments which are amortised over the lease term in accordance with the pattern of benefits provided.

#### LEASES IN THE FINANCIAL STATEMENTS OF LESSEES

##### *Finance leases*

12. ***Lessees should recognise finance leases as assets and liabilities in their balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.***
13. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.
14. If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated, thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.
15. It is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets. If for the presentation of liabilities on the face of the balance sheet a distinction is made between current and non-current liabilities, the same distinction is made for lease liabilities.
16. Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease, are included as part of the amount recognised as an asset under the lease.
17. ***Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.***
18. In practice, in allocating the finance charge to periods during the lease term, some form of approximation may be used to simplify the calculation.

## IAS 17

19. ***A finance lease gives rise to a depreciation expense for depreciable assets as well as a finance expense for each accounting period. The depreciation policy for depreciable leased assets should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in IAS 16, property, plant and equipment and IAS 38, intangible assets. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the shorter of the lease term or its useful life.***
20. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term or its useful life.
21. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense in the income statement. Accordingly, the asset and the related liability are unlikely to be equal in amount after the inception of the lease.
22. To determine whether a leased asset has become impaired, that is when the expected future economic benefits from that asset are lower than its carrying amount, an enterprise applies the International Accounting Standard dealing with impairment of assets, that sets out the requirements for how an enterprise should perform the review of the carrying amount of its assets, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.
23. ***Lessees should, in addition to the requirements of IAS 32, financial instruments: disclosure and presentation, make the following disclosures for finance leases:***
- (a) ***for each class of asset, the net carrying amount at the balance sheet date;***
  - (b) ***a reconciliation between the total of minimum lease payments at the balance sheet date, and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:***
    - (i) ***not later than one year;***
    - (ii) ***later than one year and not later than five years;***
    - (iii) ***later than five years;***
  - (c) ***contingent rents recognised in income for the period;***
  - (d) ***the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date; and***
  - (e) ***a general description of the lessees significant leasing arrangements including, but not limited to, the following:***
    - (i) ***the basis on which contingent rent payments are determined;***
    - (ii) ***the existence and terms of renewal or purchase options and escalation clauses; and***
    - (iii) ***restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.***
24. In addition, the requirements on disclosure under IAS 16, property, plant and equipment, IAS 36, impairment of assets, IAS 38, intangible assets, IAS 40, investment property and IAS 41, agriculture, apply to the amounts of leased assets under finance leases that are accounted for by the lessee as acquisitions of assets.

*Operating leases*

25. ***Lease payments under an operating lease should be recognised as an expense in the income statement on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit*** <sup>(2)</sup>.
26. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the income statement on a straight line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.
27. Lessees should, in addition to the requirements of IAS 32, financial instruments: disclosure and presentation, 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;
    - (iii) later than five years;
  - (b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;
  - (c) lease and sublease payments recognised in income for the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments;
  - (d) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:
    - (i) the basis on which contingent rent payments are determined;
    - (ii) the existence and terms of renewal or purchase options and escalation clauses; and
    - (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

## LEASES IN THE FINANCIAL STATEMENTS OF LESSORS

*Finance leases*

28. ***Lessors should recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease.***
29. Under a finance lease substantially all the risks and rewards incident to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services.
30. ***The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment outstanding in respect of the finance lease.***
31. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the lessor's net investment outstanding in respect of the finance lease. Lease payments relating to the accounting period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

<sup>(2)</sup> See also SIC-15: operating leases — incentives.

## IAS 17

32. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the lease term is revised and any reduction in respect of amounts already accrued is recognised immediately.
33. Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in income or allocated against this income over the lease term. The latter may be achieved by recognising as an expense the cost as incurred and recognising as income in the same period a portion of the unearned finance income equal to the initial direct costs.
34. ***Manufacturer or dealer lessors should recognise selling profit or loss in income for the period, in accordance with the policy followed by the enterprise for outright sales. If artificially low rates of interest are quoted, selling profit should be restricted to that which would apply if a commercial rate of interest were charged. Initial direct costs should be recognised as an expense in the income statement at the inception of the lease.***
35. 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) the 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) the finance income over the lease term.
36. The sales revenue recorded at the commencement of a finance 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 commercial 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 policy followed by the enterprise for sales.
37. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged.
38. Initial direct costs are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.
39. ***Lessors should, in addition to the requirements in IAS 32, financial instruments: disclosure and presentation, make the following disclosures for finance leases:***
- (a) ***a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:***
    - (i) ***not later than one year;***
    - (ii) ***later than one year and not later than five years;***
    - (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 in income; and*

(f) *a general description of the lessor's significant leasing arrangements.*

40. As an indicator of growth it is often useful to also disclose the gross investment less unearned income in new business added during the accounting period, after deducting the relevant amounts for cancelled leases.

*Operating leases*

41. ***Lessors should present assets subject to operating leases in their balance sheets according to the nature of the asset.***

42. ***Lease income from operating leases should be recognised in income on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished***<sup>(3)</sup>.

43. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in income on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

44. Initial direct costs incurred specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the income statement in the period in which they are incurred.

45. ***The depreciation of depreciable leased assets should be on a basis consistent with the lessor's normal depreciation policy for similar assets, and the depreciation charge should be calculated on the basis set out in IAS 16, property, plant and equipment and IAS 38, intangible assets.***

46. To determine whether a leased asset has become impaired, that is when the expected future economic benefits from that asset are lower than its carrying amount, an enterprise applies the International Accounting Standard dealing with impairment of assets that sets out the requirements for how an enterprise should perform the review of the carrying amount of its assets, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

47. 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.

48. ***Lessors should, in addition to the requirements of IAS 32, financial instruments: disclosure and presentation, make the following disclosures for operating leases:***

(a) ***the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:***

(i) ***not later than one year;***

(ii) ***later than one year and not later than five years;***

(iii) ***later than five years;***

(b) ***total contingent rents recognised in income; and***

(c) ***a general description of the lessor's significant leasing arrangements.***

- 48A. In addition, the requirements on disclosure under IAS 16, property, plant and equipment, IAS 36, impairment of assets, IAS 38, intangible assets, IAS 40, investment property and IAS 41, agriculture, apply to assets leased out under operating leases.

<sup>(3)</sup> See also SIC-15: operating leases — incentives.

## IAS 17

## SALE AND LEASEBACK TRANSACTIONS

49. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payment and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.
50. ***If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount should not be immediately recognised as income in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term.***
51. If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess, is deferred and amortised over the lease term.
52. ***If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised 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 excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.***
53. If the leaseback is an operating lease, and the lease payments and the sale price are established at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.
54. ***For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.***
55. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the International Accounting Standard dealing with impairment of assets.
56. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the significant leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.
57. Sale and leaseback transactions may meet the separate disclosure criteria in IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, paragraph 16.

## TRANSITIONAL PROVISIONS

58. ***Retrospective application of this Standard is encouraged but not required. If the Standard is not applied retrospectively, the balance of any pre-existing finance lease is deemed to have been properly determined by the lessor and should be accounted for thereafter in accordance with the provisions of this Standard.***

## EFFECTIVE DATE

59. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999. If an enterprise applies this Standard for financial statements covering periods beginning before 1 January 1999, the enterprise should disclose the fact that it has applied this Standard instead of IAS 17, accounting for leases, approved in 1982.***
60. This Standard supersedes IAS 17, accounting for leases, approved in 1982.

**INTERNATIONAL ACCOUNTING STANDARD IAS 18  
(REVISED 1993)**

**Revenue**

In 1998, IAS 39, financial instruments: recognition and measurement, amended paragraph 11 of IAS 18 by inserting a cross-reference to IAS 39.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 36. The amended text became effective for annual financial statements covering periods beginning on or after 1 January 2000.

In January 2001, IAS 41, agriculture, amended paragraph 6. IAS 41 is effective for annual financial statements covering periods beginning on or after 1 January 2003.

The following SIC interpretations relate to IAS 18:

- SIC-27: evaluating the substance of transactions in the legal form of a lease,
- SIC-31: revenue — barter transactions involving advertising services.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

OBJECTIVE

Income is defined in the framework for the preparation and presentation of financial statements as increases in economic benefits during the accounting 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 participants. Income encompasses both revenue and gains. Revenue is income that arises in the course of ordinary activities of an enterprise and is referred to by a variety of different names including sales, fees, interest, dividends and royalties. The objective of this Standard is to prescribe the accounting treatment of revenue arising from certain types of transactions and events.

**IAS 18**

The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when it is probable that future economic benefits will flow to the enterprise and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provides practical guidance on the application of these criteria.

## SCOPE

1. ***This Standard should be applied in accounting for revenue arising from the following transactions and events:***
  - (a) ***the sale of goods;***
  - (b) ***the rendering of services; and***
  - (c) ***the use by others of enterprise assets yielding interest, royalties and dividends.***
2. This Standard supersedes IAS 18, revenue recognition, approved in 1982.
3. Goods includes goods produced by the enterprise for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.
4. The rendering of services typically involves the performance by the enterprise of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to construction contracts, for example, those for the services of project managers and architects. Revenue arising from these contracts is not dealt with in this Standard but is dealt with in accordance with the requirements for construction contracts as specified in IAS 11, construction contracts.
5. The use by others of enterprise assets gives rise to revenue in the form of:
  - (a) interest — charges for the use of cash or cash equivalents or amounts due to the enterprise;
  - (b) royalties — charges for the use of long-term assets of the enterprise, for example, patents, trademarks, copyrights and computer software; and
  - (c) dividends — distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital.
6. This Standard does not deal with revenue arising from:
  - (a) lease agreements (see IAS 17, leases);
  - (b) dividends arising from investments which are accounted for under the equity method (see IAS 28, accounting for investments in associates);
  - (c) insurance contracts of insurance enterprises;
  - (d) changes in the fair value of financial assets and financial liabilities or their disposal (see IAS 39, financial instruments: recognition and measurement);
  - (e) changes in the value of other current assets;
  - (f) initial recognition and from changes in the fair value of biological assets related to agricultural activity (see IAS 41, agriculture);
  - (g) initial recognition of agricultural produce (see IAS 41, agriculture); and
  - (h) the extraction of mineral ores.

## DEFINITIONS

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

***Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants.***

***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.***

8. Revenue includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the enterprise and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the enterprise. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

## MEASUREMENT OF REVENUE

9. ***Revenue should be measured at the fair value of the consideration received or receivable*** <sup>(1)</sup>.
10. The amount of revenue arising on a transaction is usually determined by agreement between the enterprise and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the enterprise.
11. In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an enterprise may provide interest free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. 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.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with IAS 39, financial instruments: recognition and measurement.

12. When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. This is often the case with commodities like oil or milk where suppliers exchange or swap inventories in various locations to fulfil demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

<sup>(1)</sup> See also SIC-31: revenue — barter transactions involving advertising services.

**IAS 18**

## IDENTIFICATION OF THE TRANSACTION

13. The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied 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 enterprise may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

## SALE OF GOODS

14. **Revenue from the sale of goods should be recognised when all the following conditions have been satisfied:**
- (a) **the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;**
  - (b) **the enterprise 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 enterprise;**  
**and**
  - (e) **the costs incurred or to be incurred in respect of the transaction can be measured reliably.**
15. The assessment of when an enterprise 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 different time from the transfer of legal title or the passing of possession.
16. If the enterprise retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. An enterprise may retain a significant risk of ownership in a number of ways. Examples of situations in which the enterprise may retain the significant risks and rewards of ownership are:
- (a) when the enterprise retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
  - (b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;
  - (c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the enterprise; and
  - (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the enterprise is uncertain about the probability of return.
17. If an enterprise retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised. For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the enterprise has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognised. Another example of an enterprise retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

18. Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. For example, it may be uncertain that a foreign governmental authority will grant permission to remit the consideration from a sale in a foreign country. When the permission is granted, the uncertainty is removed and revenue is recognised. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.
19. Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses. Expenses, including warranties and other costs to be incurred after the shipment of the goods can normally be measured reliably when the other conditions for the recognition of revenue have been satisfied. However, revenue cannot be recognised when the expenses cannot be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognised as a liability.

#### RENDERING OF SERVICES

20. ***When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction at the balance sheet date. 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 enterprise;***
  - (c) ***the stage of completion of the transaction at the balance sheet date can be measured reliably; and***
  - (d) ***the costs incurred for the transaction and the costs to complete the transaction can be measured reliably*** <sup>(2)</sup> <sup>(3)</sup>.
21. The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognised in the accounting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period. IAS 11, construction contracts, also requires the recognition of revenue on this basis. The requirements of that Standard are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services.
22. Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.
23. An enterprise is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:
- (a) each party's enforceable rights regarding the service to be provided and received by the parties;
  - (b) the consideration to be exchanged; and
  - (c) the manner and terms of settlement.

It is also usually necessary for the enterprise to have an effective internal financial budgeting and reporting system. The enterprise reviews and, when necessary, revises the estimates of revenue as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

<sup>(2)</sup> See also SIC-27: evaluating the substance of transactions in the legal form of a lease.

<sup>(3)</sup> See also SIC-31: revenue — barter transactions involving advertising services.

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24. The stage of completion of a transaction may be determined by a variety of methods. An enterprise uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:
- (a) surveys of work performed;
  - (b) services performed to date as a percentage of total services to be performed; or
  - (c) the proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.

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

25. For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised 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 acts, the recognition of revenue is postponed until the significant act is executed.
26. ***When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognised only to the extent of the expenses recognised that are recoverable.***
27. During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the enterprise will recover the transaction costs incurred. Therefore, revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no profit is recognised.
28. When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, revenue is not recognised and the costs incurred are recognised as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognised in accordance with paragraph 20 rather than in accordance with paragraph 26.

**INTEREST, ROYALTIES AND DIVIDENDS**

29. ***Revenue arising from the use by others of enterprise assets yielding interest, royalties and dividends should be recognised on the bases set out in paragraph 30 when:***
- (a) ***it is probable that the economic benefits associated with the transaction will flow to the enterprise; and***
  - (b) ***the amount of the revenue can be measured reliably.***
30. ***Revenue should be recognised on the following bases:***
- (a) ***interest should be recognised on a time proportion basis that takes into account the effective yield on the asset;***
  - (b) ***royalties should be recognised on an accrual basis in accordance with the substance of the relevant agreement; and***
  - (c) ***dividends should be recognised when the shareholder's right to receive payment is established.***
31. The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to equate to the initial carrying amount of the asset. Interest revenue includes the amount of amortisation of any discount, premium or other difference between the initial carrying amount of a debt security and its amount at maturity.

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32. When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognised as revenue. When dividends on equity securities are declared from pre-acquisition net income, those dividends are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis, dividends are recognised as revenue unless they clearly represent a recovery of part of the cost of the equity securities.
33. Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise revenue on some other systematic and rational basis.
34. Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

## DISCLOSURE

35. ***An enterprise should 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 significant category of revenue recognised during the period including revenue arising from:***
    - (i) ***the sale of goods;***
    - (ii) ***the rendering of services;***
    - (iii) ***interest;***
    - (iv) ***royalties;***
    - (v) ***dividends; and***
  - (c) ***the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.***
36. An enterprise discloses any contingent liabilities and contingent assets in accordance with IAS 37, provisions, contingent liabilities and contingent assets. Contingent liabilities and contingent assets may arise from items such as warranty costs, claims, penalties or possible losses.

## EFFECTIVE DATE

37. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1995.***

**INTERNATIONAL ACCOUNTING STANDARD IAS 19  
(REVISED 2002)**

**Employee Benefits**

This revised International Accounting Standard supersedes IAS 19, retirement benefit costs, which was approved by the Board in a revised version in 1993. This revised Standard became operative for financial statements covering periods beginning on or after 1 January 1999.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraphs 20(b), 35, 125 and 141. These amendments became operative for annual financial statements covering periods beginning on or after 1 January 2000.

**IAS 19**

This Standard was amended in 2000 to change the definition of plan assets and to introduce recognition, measurement and disclosure requirements for reimbursements. These amendments became operative for accounting periods beginning on or after 1 January 2001.

Further amendments were made in 2002 to prevent the recognition of gains solely as a result of actuarial losses or past service cost and the recognition of losses solely as a result of actuarial gains. These amendments take effect for accounting periods ending on or after 31 May 2002. Earlier application is encouraged.

**INTRODUCTION**

1. The Standard prescribes the accounting and disclosure by employers for employee benefits. It replaces IAS 19, retirement benefit costs, which was approved in 1993. The major changes from the old IAS 19 are set out in the Basis for conclusions (Appendix D). The Standard does not deal with reporting by employee benefit plans (see IAS 26, accounting and reporting by retirement benefit plans).
2. The Standard identifies five categories of employee benefits:
  - (a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within 12 months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
  - (b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;
  - (c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are payable 12 months or more after the end of the period, profit-sharing, bonuses and deferred compensation;
  - (d) termination benefits; and
  - (e) equity compensation benefits.
3. The Standard requires an enterprise to recognise short-term employee benefits when an employee has rendered service in exchange for those benefits.
4. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans. The Standard gives specific guidance on the classification of multi-employer plans, State plans and plans with insured benefits.
5. Under defined contribution plans, an enterprise pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. The Standard requires an enterprise to recognise contributions to a defined contribution plan when an employee has rendered service in exchange for those contributions.
6. All other post-employment benefit plans are defined benefit plans. Defined benefit plans may be unfunded, or they may be wholly or partly funded. The Standard requires an enterprise to:
  - (a) account not only for its legal obligation, but also for any constructive obligation that arises from the enterprise's practices;

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- (b) determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date;
- (c) use the projected unit credit method to measure its obligations and costs;
- (d) attribute benefit to periods of service under the plan's benefit formula, unless an employee's service in later years will lead to a materially higher level of benefit than in earlier years;
- (e) use unbiased and mutually compatible actuarial assumptions about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries, changes in medical costs and certain changes in State benefits). Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations are to be settled;
- (f) determine the discount rate by reference to market yields at the balance sheet date on high quality corporate bonds (or, in countries where there is no deep market in such bonds, government bonds) of a currency and term consistent with the currency and term of the post-employment benefit obligations;
- (g) deduct the fair value of any plan assets from the carrying amount of the obligation. Certain reimbursement rights that do not qualify as plan assets are treated in the same way as plan assets, except that they are presented as a separate asset, rather than as a deduction from the obligation;
- (h) limit the carrying amount of an asset so that it does not exceed the net total of:
  - (i) any unrecognised past service cost and actuarial losses; plus
  - (ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan;
- (i) recognise past service cost on a straight-line basis over the average period until the amended benefits become vested;
- (j) recognise gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss should comprise any resulting change in the present value of the defined benefit obligation and of the fair value of the plan assets and the unrecognised part of any related actuarial gains and losses and past service cost; and
- (k) recognise a specified portion of the net cumulative actuarial gains and losses that exceed the greater of:
  - (i) 10 % of the present value of the defined benefit obligation (before deducting plan assets); and
  - (ii) 10 % of the fair value of any plan assets.

The portion of actuarial gains and losses to be recognised for each defined benefit plan is the excess that fell outside the 10 % 'corridor' at the previous reporting date, divided by the expected average remaining working lives of the employees participating in that plan.

The Standard also permits systematic methods of faster recognition, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. Such permitted methods include immediate recognition of all actuarial gains and losses.

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7. The Standard requires a simpler method of accounting for other long-term employee benefits than for post-employment benefits: actuarial gains and losses and past service cost are recognised immediately.
8. Termination benefits are employee benefits payable as a result of either: an enterprise's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary redundancy in exchange for those benefits. The event which gives rise to an obligation is the termination rather than employee service. Therefore, an enterprise should recognise termination benefits when, and only when, the enterprise is demonstrably committed to either:
  - (a) terminate the employment of an employee or group of employees before the normal retirement date; or
  - (b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.
9. An enterprise is demonstrably committed to a termination when, and only when, the enterprise has a detailed formal plan (with specified minimum contents) for the termination and is without realistic possibility of withdrawal.
10. Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.
11. Equity compensation benefits are employee benefits under which either: employees are entitled to receive equity financial instruments issued by the enterprise (or its parent); or the amount of the enterprise's obligation to employees depends on the future price of equity financial instruments issued by the enterprise. The Standard requires certain disclosures about such benefits, but does not specify recognition and measurement requirements.
12. The Standard is effective for accounting periods beginning on or after 1 January 1999. Earlier application is encouraged. On first adopting the Standard, an enterprise is permitted to recognise any resulting increase in its liability for post-employment benefits over not more than five years. If the adoption of the standard decreases the liability, an enterprise is required to recognise the decrease immediately.
13. This Standard was amended in 2000 to amend the definition of plan assets and to introduce recognition, measurement and disclosure requirements for reimbursements. These amendments take effect for accounting periods beginning on or after 1 January 2001. Earlier application is encouraged.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

**OBJECTIVE**

The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an enterprise to recognise:

- (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- (b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

**SCOPE**

1. ***This Standard should be applied by an employer in accounting for employee benefits.***
2. This Standard does not deal with reporting by employee benefit plans (see IAS 26, accounting and reporting by retirement benefit plans).
3. This Standard applies to all employee benefits, including those provided:
  - (a) under formal plans or other formal agreements between an enterprise and individual employees, groups of employees or their representatives;

- (b) under legislative requirements, or through industry arrangements, whereby enterprises are required to contribute to national, State, industry or other multi-employer plans; or
  - (c) by those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the enterprise has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the enterprise's informal practices would cause unacceptable damage to its relationship with employees.
4. Employee benefits include:
- (a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within 12 months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
  - (b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;
  - (c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within 12 months after the end of the period, profit-sharing, bonuses and deferred compensation;
  - (d) termination benefits; and
  - (e) equity compensation benefits.

Because each category identified in (a) to (e) has different characteristics, this Standard establishes separate requirements for each category.

5. Employee benefits include benefits provided to either employees or their dependants and may be settled by payments (or the provision of goods or services) made either directly to the employees, to their spouses, children or other dependants or to others, such as insurance companies.
6. An employee may provide services to an enterprise on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, employees include directors and other management personnel.

#### DEFINITIONS

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

*Employee benefits are all forms of consideration given by an enterprise in exchange for service rendered by employees.*

*Short-term employee benefits are employee benefits (other than termination benefits and equity compensation benefits) which fall due wholly within 12 months after the end of the period in which the employees render the related service.*

*Post-employment benefits are employee benefits (other than termination benefits and equity compensation benefits) which are payable after the completion of employment.*

*Post-employment benefit plans are formal or informal arrangements under which an enterprise provides post-employment benefits for one or more employees.*

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*Defined contribution plans are post-employment benefit plans under which an enterprise pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.*

*Defined benefit plans are post-employment benefit plans other than defined contribution plans.*

*Multi-employer plans are defined contribution plans (other than State plans) or defined benefit plans (other than State plans) that:*

- (a) pool the assets contributed by various enterprises that are not under common control; and*
- (b) use those assets to provide benefits to employees of more than one enterprise, on the basis that contribution and benefit levels are determined without regard to the identity of the enterprise that employs the employees concerned.*

*Other long-term employee benefits are employee benefits (other than post-employment benefits, termination benefits and equity compensation benefits) which do not fall due wholly within 12 months after the end of the period in which the employees render the related service.*

*Termination benefits are employee benefits payable as a result of either:*

- (a) an enterprise'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.*

*Equity compensation benefits are employee benefits under which either:*

- (a) employees are entitled to receive equity financial instruments issued by the enterprise (or its parent); or*
- (b) the amount of the enterprise's obligation to employees depends on the future price of equity financial instruments issued by the enterprise.*

*Equity compensation plans are formal or informal arrangements under which an enterprise provides equity compensation benefits for one or more employees.*

*Vested employee benefits are employee benefits that are not conditional on future employment.*

*The present value of a defined benefit obligation is 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.*

*Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.*

*Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.*

*Plan assets comprise:*

- (a) assets held by a long-term employee benefit fund; and*
- (b) qualifying insurance policies.*

*Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting enterprise) that:*

- (a) *are held by an entity (a fund) that is legally separate from the reporting enterprise and exists solely to pay or fund employee benefits; and*
- (b) *are available to be used only to pay or fund employee benefits, are not available to the reporting enterprise's own creditors (even in bankruptcy), and cannot be returned to the reporting enterprise, unless either:*
  - (i) *the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting enterprise; or*
  - (ii) *the assets are returned to the reporting enterprise to reimburse it for employee benefits already paid.*

*A qualifying insurance policy is an insurance policy issued by an insurer that is not a related party (as defined in IAS 24, related party disclosures) of the reporting enterprise, if the proceeds of the policy:*

- (a) *can be used only to pay or fund employee benefits under a defined benefit plan; and*
- (b) *are not available to the reporting enterprise's own creditors (even in bankruptcy) and cannot be paid to the reporting enterprise, unless either:*
  - (i) *the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or*
  - (ii) *the proceeds are returned to the reporting enterprise to reimburse it for employee benefits already paid.*

*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.*

*The return on plan assets is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.*

*Actuarial gains and losses comprise:*

- (a) *experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and*
- (b) *the effects of changes in actuarial assumptions.*

*Past service cost is the increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).*

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## SHORT-TERM EMPLOYEE BENEFITS

8. 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) where the absences are expected to occur within 12 months after the end of the period in which the employees render the related employee service;
  - (c) profit-sharing and bonuses payable within 12 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.
9. Accounting for short-term employee benefits is generally straightforward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

*Recognition and measurement*

## All short-term employee benefits

10. ***When an employee has rendered service to an enterprise during an accounting period, the enterprise should recognise the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:***
- (a) ***as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an enterprise should recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and***
  - (b) ***as an expense, unless another International Accounting Standard requires or permits the inclusion of the benefits in the cost of an asset (see, for example, IAS 2, inventories, and IAS 16, property, plant and equipment).***

***Paragraphs 11, 14 and 17 explain how an enterprise should apply this requirement to short-term employee benefits in the form of compensated absences and profit-sharing and bonus plans.***

## Short-term compensated absences

11. ***An enterprise should recognise the expected cost of short-term employee benefits in the form of compensated absences under paragraph 10 as follows:***
- (a) ***in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and***
  - (b) ***in the case of non-accumulating compensated absences, when the absences occur.***
12. An enterprise may compensate employees for absence for various reasons including vacation, sickness and short-term disability, maternity or paternity, jury service and military service. Entitlement to compensated absences falls into two categories:
- (a) accumulating; and
  - (b) non-accumulating.

13. Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the enterprise) or non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognised, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.
14. ***An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.***
15. The method specified in the previous paragraph measures the obligation at the amount of the additional payments that are expected to arise solely from the fact that the benefit accumulates. In many cases, an enterprise may not need to make detailed computations to estimate that there is no material obligation for unused compensated absences. For example, a sick leave obligation is likely to be material only if there is a formal or informal understanding that unused paid sick leave may be taken as paid vacation.

#### Example illustrating paragraphs 14 and 15

An enterprise has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X1, the average unused entitlement is two days per employee. The enterprise expects, based on past experience which is expected to continue, that 92 employees will take no more than five days of paid sick leave in 20X2 and that the remaining eight employees will take an average of six and a half days each.

The enterprise expects that it will pay an additional 12 days of sick pay as a result of the unused entitlement that has accumulated at 31 December 20X1 (one and a half days each, for eight employees). Therefore, the enterprise recognises a liability equal to 12 days of sick pay.

16. Non-accumulating compensated absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the enterprise. This is commonly the case for sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave and compensated absences for jury service or military service. An enterprise recognises no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit.

#### Profit-sharing and bonus plans

17. ***An enterprise should recognise the expected cost of profit-sharing and bonus payments under paragraph 10 when, and only when:***
- (a) ***the enterprise has a present legal or constructive obligation to make such payments as a result of past events; and***
  - (b) ***a reliable estimate of the obligation can be made.***

***A present obligation exists when, and only when, the enterprise has no realistic alternative but to make the payments.***

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18. Under some profit-sharing plans, employees receive a share of the profit only if they remain with the enterprise for a specified period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit-sharing payments.

*Example illustrating paragraph 18*

A profit-sharing plan requires an enterprise to pay a specified proportion of its net profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3 % of net profit. The enterprise estimates that staff turnover will reduce the payments to 2,5 % of net profit.

The enterprise recognises a liability and an expense of 2,5 % of net profit.

19. An enterprise may have no legal obligation to pay a bonus. Nevertheless, in some cases, an enterprise has a practice of paying bonuses. In such cases, the enterprise has a constructive obligation because the enterprise has no realistic alternative but to pay the bonus. The measurement of the constructive obligation reflects the possibility that some employees may leave without receiving a bonus.
20. An enterprise can make a reliable estimate of its legal or constructive obligation under a profit-sharing or bonus plan when, and only when:
- (a) the formal terms of the plan contain a formula for determining the amount of the benefit;
  - (b) the enterprise determines the amounts to be paid before the financial statements are authorised for issue; or
  - (c) past practice gives clear evidence of the amount of the enterprise's constructive obligation.
21. An obligation under profit-sharing and bonus plans results from employee service and not from a transaction with the enterprise's owners. Therefore, an enterprise recognises the cost of profit-sharing and bonus plans not as a distribution of net profit but as an expense.
22. If profit-sharing and bonus payments are not due wholly within 12 months after the end of the period in which the employees render the related service, those payments are other long-term employee benefits (see paragraphs 126 to 131). If profit-sharing and bonus payments meet the definition of equity compensation benefits, an enterprise treats them under paragraphs 144 to 152.

*Disclosure*

23. Although this Standard does not require specific disclosures about short-term employee benefits, other International Accounting Standards may require disclosures. For example, where required by IAS 24, related party disclosures, an enterprise discloses information about employee benefits for key management personnel. IAS 1, presentation of financial statements, requires that an enterprise should disclose staff costs.

**POST-EMPLOYMENT BENEFITS: DISTINCTION BETWEEN DEFINED CONTRIBUTION PLANS AND DEFINED BENEFIT PLANS**

24. 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 enterprise provides post-employment benefits are post-employment benefit plans. An enterprise applies this Standard to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits.

25. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions. Under defined contribution plans:
- (a) the enterprise's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an enterprise (and perhaps also the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and
  - (b) in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.
26. Examples of cases where an enterprise's obligation is not limited to the amount that it agrees to contribute to the fund are when the enterprise has a legal or constructive obligation through:
- (a) a plan benefit formula that is not linked solely to the amount of contributions;
  - (b) a guarantee, either indirectly through a plan or directly, of a specified return on contributions; or
  - (c) those informal practices that give rise to a constructive obligation. For example, a constructive obligation may arise where an enterprise has a history of increasing benefits for former employees to keep pace with inflation even where there is no legal obligation to do so.
27. Under defined benefit plans:
- (a) the enterprise's obligation is to provide the agreed benefits to current and former employees; and
  - (b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the enterprise. If actuarial or investment experience are worse than expected, the enterprise's obligation may be increased.
28. Paragraphs 29 to 42 explain the distinction between defined contribution plans and defined benefit plans in the context of multi-employer plans, State plans and insured benefits.

#### *Multi-employer plans*

29. ***An enterprise should classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an enterprise should:***
- (a) ***account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and***
  - (b) ***disclose the information required by paragraph 120.***

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30. ***When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an enterprise should:***
- (a) ***account for the plan under paragraphs 44 to 46 as if it were a defined contribution plan;***
  - (b) ***disclose:***
    - (i) ***the fact that the plan is a defined benefit plan; and***
    - (ii) ***the reason why sufficient information is not available to enable the enterprise to account for the plan as a defined benefit plan; and***
  - (c) ***to the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:***
    - (i) ***any available information about that surplus or deficit;***
    - (ii) ***the basis used to determine that surplus or deficit; and***
    - (iii) ***the implications, if any, for the enterprise.***
31. One example of a defined benefit multi-employer plan is one where:
- (a) the plan is financed on a pay-as-you-go basis such that: contributions are set at a level that is expected to be sufficient to pay the benefits falling due in the same period; and future benefits earned during the current period will be paid out of future contributions; and
  - (b) employees' benefits are determined by the length of their service and the participating enterprises have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal. Such a plan creates actuarial risk for the enterprise: if the ultimate cost of benefits already earned at the balance sheet date is more than expected, the enterprise will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.
32. Where sufficient information is available about a multi-employer plan which is a defined benefit plan, an enterprise accounts for its proportionate share of the defined benefit obligation, plan assets and post-employment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, in some cases, an enterprise may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:
- (a) the enterprise does not have access to information about the plan that satisfies the requirements of this Standard; or
  - (b) the plan exposes the participating enterprises to actuarial risks associated with the current and former employees of other enterprises, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual enterprises participating in the plan.
- In those cases, an enterprise accounts for the plan as if it were a defined contribution plan and discloses the additional information required by paragraph 30.
33. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating enterprises to actuarial risks associated with the current and former employees of other enterprises. The definitions in this Standard require an enterprise to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any constructive obligation that goes beyond the formal terms).

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34. Defined benefit plans that pool the assets contributed by various enterprises under common control, for example, a parent and its subsidiaries, are not multi-employer plans. Therefore, an enterprise treats all such plans as defined benefit plans.
35. IAS 37, provisions, contingent liabilities and contingent assets, requires an enterprise to recognise, or disclose information about, certain contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:
- (a) actuarial losses relating to other participating enterprises because each enterprise that participates in a multi-employer plan shares in the actuarial risks of every other participating enterprise; or
  - (b) any responsibility under the terms of a plan to finance any shortfall in the plan if other enterprises cease to participate.

*State plans*

36. An enterprise should account for a State plan in the same way as for a multi-employer plan (see paragraphs 29 and 30).
37. State plans are established by legislation to cover all enterprises (or all enterprises in a particular category, for example, a specific industry) and are 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 enterprise. Some plans established by an enterprise provide both compulsory benefits which substitute for benefits that would otherwise be covered under a State plan and additional voluntary benefits. Such plans are not State plans.
38. State plans are characterised as defined benefit or defined contribution in nature based on the enterprise's obligation under the plan. Many State plans are funded on a pay-as-you-go basis: contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Nevertheless, in most State plans, the enterprise has no legal or constructive obligation to pay those future benefits: its only obligation is to pay the contributions as they fall due and if the enterprise ceases to employ members of the State plan, it will have no obligation to pay the benefits earned by its own employees in previous years. For this reason, State plans are normally defined contribution plans. However, in the rare cases when a State plan is a defined benefit plan, an enterprise applies the treatment prescribed in paragraphs 29 and 30.

*Insured benefits*

39. ***An enterprise may pay insurance premiums to fund a post-employment benefit plan. The enterprise should treat such a plan as a defined contribution plan unless the enterprise will have (either directly, or indirectly through the plan) a legal or constructive obligation to either:***
- (a) ***pay the employee benefits directly when they fall due; or***
  - (b) ***pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.***

***If the enterprise retains such a legal or constructive obligation, the enterprise should treat the plan as a defined benefit plan.***

40. The benefits insured by an insurance contract need not have a direct or automatic relationship with the enterprise's obligation for employee benefits. Post-employment benefit plans involving insurance contracts are subject to the same distinction between accounting and funding as other funded plans.

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41. Where an enterprise funds a post-employment benefit obligation by contributing to an insurance policy under which the enterprise (either directly, indirectly through the plan, through the mechanism for setting future premiums or through a related party relationship with the insurer) retains a legal or constructive obligation, the payment of the premiums does not amount to a defined contribution arrangement. It follows that the enterprise:
- (a) accounts for a qualifying insurance policy as a plan asset (see paragraph 7); and
  - (b) recognises other insurance policies as reimbursement rights (if the policies satisfy the criteria in paragraph 104A).
42. Where an insurance policy is in the name of a specified plan participant or a group of plan participants and the enterprise does not have any legal or constructive obligation to cover any loss on the policy, the enterprise has no obligation to pay benefits to the employees and the insurer has sole responsibility for paying the benefits. The payment of fixed premiums under such contracts is, in substance, the settlement of the employee benefit obligation, rather than an investment to meet the obligation. Consequently, the enterprise no longer has an asset or a liability. Therefore, an enterprise treats such payments as contributions to a defined contribution plan.

## POST-EMPLOYMENT BENEFITS: DEFINED CONTRIBUTION PLANS

43. Accounting for defined contribution plans is straightforward because the reporting enterprise's obligation for each period is determined by the amounts to be contributed for that period. Consequently, no actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss. Moreover, the obligations are measured on an undiscounted basis, except where they do not fall due wholly within 12 months after the end of the period in which the employees render the related service.

*Recognition and measurement*

44. **When an employee has rendered service to an enterprise during a period, the enterprise should recognise the contribution payable to a defined contribution plan in exchange for that service:**
- (a) **as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the balance sheet date, an enterprise should recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and**
  - (b) **as an expense, unless another International Accounting Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IAS 2, inventories, and IAS 16, property, plant and equipment).**
45. **Where contributions to a defined contribution plan do not fall due wholly within 12 months after the end of the period in which the employees render the related service, they should be discounted using the discount rate specified in paragraph 78.**

*Disclosure*

46. **An enterprise should disclose the amount recognised as an expense for defined contribution plans.**
47. Where required by IAS 24, related party disclosures, an enterprise discloses information about contributions to defined contribution plans for key management personnel.

## POST-EMPLOYMENT BENEFITS: DEFINED BENEFIT PLANS

48. Accounting for defined benefit plans is complex because actuarial assumptions are required to measure the obligation and the expense and there is a possibility of actuarial gains and losses. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

*Recognition and measurement*

49. Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an enterprise, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting enterprise and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an enterprise's ability (and willingness) to make good any shortfall in the fund's assets. Therefore, the enterprise is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognised for a defined benefit plan is not necessarily the amount of the contribution due for the period.
50. Accounting by an enterprise for defined benefit plans involves the following steps:
- (a) using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an enterprise to determine how much benefit is attributable to the current and prior periods (see paragraphs 67 to 71) 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 will influence the cost of the benefit (see paragraphs 72 to 91);
  - (b) discounting that benefit using the projected unit credit method in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 64 to 66);
  - (c) determining the fair value of any plan assets (see paragraphs 102 to 104);
  - (d) determining the total amount of actuarial gains and losses and the amount of those actuarial gains and losses that should be recognised (see paragraphs 92 to 95);
  - (e) where a plan has been introduced or changed, determining the resulting past service cost (see paragraphs 96 to 101); and
  - (f) where a plan has been curtailed or settled, determining the resulting gain or loss (see paragraphs 109 to 115).

Where an enterprise has more than one defined benefit plan, the enterprise applies these procedures for each material plan separately.

51. In some cases, estimates, averages and computational shortcuts may provide a reliable approximation of the detailed computations illustrated in this Standard.

*Accounting for the constructive obligation*

52. ***An enterprise should account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the enterprise's informal practices. Informal practices give rise to a constructive obligation where the enterprise has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the enterprise's informal practices would cause unacceptable damage to its relationship with employees.***
53. The formal terms of a defined benefit plan may permit an enterprise to terminate its obligation under the plan. Nevertheless, it is usually difficult for an enterprise to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an enterprise which is currently promising such benefits will continue to do so over the remaining working lives of employees.

*Balance sheet*

54. ***The amount recognised as a defined benefit liability should be the net total of the following amounts:***
- (a) ***the present value of the defined benefit obligation at the balance sheet date (see paragraph 64);***

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- (b) *plus any actuarial gains (less any actuarial losses) not recognised because of the treatment set out in paragraphs 92 to 93;*
  - (c) *minus any past service cost not yet recognised (see paragraph 96);*
  - (d) *minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102 to 104).*
55. The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets.
56. ***An enterprise should determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date.***
57. This Standard encourages, but does not require, an enterprise to involve a qualified actuary in the measurement of all material post-employment benefit obligations. For practical reasons, an enterprise may request a qualified actuary to carry out a detailed valuation of the obligation before the balance sheet date. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the balance sheet date.
58. ***The amount determined under paragraph 54 may be negative (an asset). An enterprise should measure the resulting asset at the lower of:***
- (a) *the amount determined under paragraph 54; and*
  - (b) *the total of:*
    - (i) *any cumulative unrecognised net actuarial losses and past service cost (see paragraphs 92, 93 and 96); and*
    - (ii) *the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits should be determined using the discount rate specified in paragraph 78.*
- 58A. ***The application of paragraph 58 should not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The enterprise should therefore recognise immediately under paragraph 54 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):***
- (a) *net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period should be recognised immediately under paragraph 54,*
  - (b) *net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period should be recognised immediately under paragraph 54.*
- 58B. Paragraph 58A applies to an enterprise only if it has, at the beginning or end of the accounting period, a surplus<sup>(1)</sup> in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, past service cost and actuarial losses that arise in the period, the recognition of which is deferred under paragraph 54, will increase the amount specified in paragraph 58(b)(i). If that increase is not offset by an equal decrease in the present value of economic benefits that qualify for recognition under paragraph 58(b)(ii), there will be an increase in the net

<sup>(1)</sup> A surplus is an excess of the fair value of the plan assets over the present value of the defined benefit obligation.

total specified by paragraph 58(b) and, hence, a recognised gain. Paragraph 58A prohibits the recognition of a gain in these circumstances. The opposite effect arises with actuarial gains that arise in the period, the recognition of which is deferred under paragraph 54, to the extent that the actuarial gains reduce cumulative unrecognised actuarial losses. Paragraph 58A prohibits the recognition of a loss in these circumstances. For examples of the application of this paragraph, see Appendix C.

59. An asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognised. An enterprise recognises an asset in such cases because:
- (a) the enterprise controls a resource, which is the ability to use the surplus to generate future benefits;
  - (b) that control is a result of past events (contributions paid by the enterprise and service rendered by the employee); and
  - (c) future economic benefits are available to the enterprise in the form of a reduction in future contributions or a cash refund, either directly to the enterprise or indirectly to another plan in deficit.
60. The limit in paragraph 58(b) does not over-ride the delayed recognition of certain actuarial losses (see paragraphs 92 and 93) and certain past service cost (see paragraph 96), other than as specified in paragraph 58A. However, that limit does over-ride the transitional option in paragraph 155(b). Paragraph 120(c)(vi) requires an enterprise to disclose any amount not recognised as an asset because of the limit in paragraph 58(b).

#### Example illustrating paragraph 60

A defined benefit plan has the following characteristics:

Present value of the obligation	1,1
Fair value of plan assets	<u>(1 190)</u>
	(90)
Unrecognised actuarial losses	(110)
Unrecognised past service cost	(70)
Unrecognised increase in the liability on initial adoption of the Standard under paragraph 155(b)	<u>(50)</u>
Negative amount determined under paragraph 54	<u>(320)</u>
Present value of available future refunds and reductions in future contributions	<u>90</u>
The limit under paragraph 58(b) is computed as follows:	
unrecognised actuarial losses	110
unrecognised past service cost	70
present value of available future refunds and reductions in future contributions	<u>90</u>
Limit	<u>270</u>

270 is less than 320. Therefore, the enterprise recognises an asset of 270 and discloses that the limit reduced the carrying amount of the asset by 50 (see paragraph 120(c)(vi)).

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## Income statement

61. **An enterprise should recognise the net total of the following amounts as expense or (subject to the limit in paragraph 58(b)) income, except to the extent that another International Accounting Standard requires or permits their inclusion in the cost of an asset:**
- (a) **current service cost (see paragraphs 63 to 91);**
  - (b) **interest cost (see paragraph 82);**
  - (c) **the expected return on any plan assets (see paragraphs 105 to 107) and on any reimbursement rights (paragraph 104A);**
  - (d) **actuarial gains and losses, to the extent that they are recognised under paragraphs 92 and 93;**
  - (e) **past service cost, to the extent that paragraph 96 requires an enterprise to recognise it; and**
  - (f) **the effect of any curtailments or settlements (see paragraphs 109 and 110).**
62. Other International Accounting Standards require the inclusion of certain employee benefit costs within the cost of assets such as inventories or property, plant and equipment (see IAS 2, inventories, and IAS 16, property, plant and equipment). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 61.

*Recognition and measurement: present value of defined benefit obligations and current service cost*

63. The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, medical cost trends and, for a funded plan, the investment earnings on the plan assets. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:
- (a) apply an actuarial valuation method (see paragraphs 64 to 66);
  - (b) attribute benefit to periods of service (see paragraphs 67 to 71); and
  - (c) make actuarial assumptions (see paragraphs 72 to 91).

*Actuarial valuation method*

64. **An enterprise should use the projected unit credit method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.**
65. The projected unit credit method (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) sees each period of service as giving rise to an additional unit of benefit entitlement (see paragraphs 67 to 71) and measures each unit separately to build up the final obligation (see paragraphs 72 to 91).
66. An enterprise discounts the whole of a post-employment benefit obligation, even if part of the obligation falls due within 12 months of the balance sheet date.

## Example illustrating paragraph 65

A lump sum benefit is payable on termination of service and equal to 1 % of final salary for each year of service. The salary in year 1 is 10 000 and is assumed to increase at 7 % (compound) each year. The discount rate used is 10 % per annum. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year 5, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the enterprise at an earlier or later date.

Year	1	2	3	4	5
Benefit attributed to:					
— prior years	0	131	262	393	524
— current year (1 % of final salary)	<u>131</u>	<u>131</u>	<u>131</u>	<u>131</u>	<u>131</u>
— current and prior years	<u>131</u>	<u>262</u>	<u>393</u>	<u>524</u>	<u>655</u>
Opening obligation	—	89	196	324	476
Interest at 10 %	—	9	20	33	48
Current service cost	<u>89</u>	<u>98</u>	<u>108</u>	<u>119</u>	<u>131</u>
Closing obligation	<u>89</u>	<u>196</u>	<u>324</u>	<u>476</u>	<u>655</u>

Note:

1. The opening obligation is the present value of benefit attributed to prior years.
2. The current service cost is the present value of benefit attributed to the current year.
3. The closing obligation is the present value of benefit attributed to current and prior years.

## Attributing benefit to periods of service

67. ***In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an enterprise should attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an enterprise should attribute benefit on a straight-line basis from:***
- (a) ***the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until***
  - (b) ***the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.***
68. The projected unit credit method requires an enterprise to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An enterprise attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as employees render services in return for post-employment benefits which an enterprise expects to pay in future reporting periods. Actuarial techniques allow an enterprise to measure that obligation with sufficient reliability to justify recognition of a liability.

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## Examples illustrating paragraph 68

1. A defined benefit plan provides a lump-sum benefit of 100 payable on retirement for each year of service.

A benefit of 100 is attributed to each year. The current service cost is the present value of 100. The present value of the defined benefit obligation is the present value of 100, multiplied by the number of years of service up to the balance sheet date.

If the benefit is payable immediately when the employee leaves the enterprise, the current service cost and the present value of the defined benefit obligation reflect the date at which the employee is expected to leave. Thus, because of the effect of discounting, they are less than the amounts that would be determined if the employee left at the balance sheet date.

2. A plan provides a monthly pension of 0,2 % of final salary for each year of service. The pension is payable from the age of 65.

Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0,2 % of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0,2 % of final salary, multiplied by the number of years of service up to the balance sheet date. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 65.

69. 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 vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive balance sheet 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 enterprise considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, 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.

## Examples illustrating paragraph 69

1. A plan pays a benefit of 100 for each year of service. The benefits vest after ten years of service.

A benefit of 100 is attributed to each year. In each of the first 10 years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete 10 years of service.

2. A plan pays a benefit of 100 for each year of service, excluding service before the age of 25. The benefits vest immediately.

No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of 100 is attributed to each subsequent year.

70. The obligation increases until the date when further service by the employee will lead to no material amount of further benefits. Therefore, all benefit is attributed to periods ending on or before that date. Benefit is attributed to individual accounting periods under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an enterprise attributes benefit on a straight-line basis until the date when further service by the employee will lead to no material amount of further benefits. That is because the employee's service throughout the entire period will ultimately lead to benefit at that higher level.

## Examples illustrating paragraph 70

1. A plan pays a lump-sum benefit of 1 000 that vests after 10 years of service. The plan provides no further benefit for subsequent service.

A benefit of 100 (1 000 divided by 10) is attributed to each of the first 10 years. The current service cost in each of the first 10 years reflects the probability that the employee may not complete 10 years of service. No benefit is attributed to subsequent years.

2. A plan pays a lump-sum retirement benefit of 2 000 to all employees who are still employed at the age of 55 after 20 years of service, or who are still employed at the age of 65, regardless of their length of service.

For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the enterprise attributes benefit of 100 (2 000 divided by 20) to each year from the age of 35 to the age of 55.

For employees who join between the ages of 35 and 45, service beyond 20 years will lead to no material amount of further benefits. For these employees, the enterprise attributes benefit of 100 (2 000 divided by 20) to each of the first 20 years.

For an employee who joins at the age of 55, service beyond 10 years will lead to no material amount of further benefits. For this employee, the enterprise attributes benefit of 200 (2 000 divided by 10) to each of the first 10 years.

For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.

3. A post-employment medical plan reimburses 40 % of an employee's post-employment medical costs if the employee leaves after more than 10 and less than 20 years of service and 50 % of those costs if the employee leaves after 20 or more years of service.

Under the plan's benefit formula, the enterprise attributes 4 % of the present value of the expected medical costs (40 % divided by 10) to each of the first 10 years and 1 % (10 % divided by 10) to each of the second 10 years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits. For employees expected to leave within 10 years, no benefit is attributed.

4. A post-employment medical plan reimburses 10 % of an employee's post-employment medical costs if the employee leaves after more than 10 and less than 20 years of service and 50 % of those costs if the employee leaves after 20 or more years of service.

Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after 20 or more years, the enterprise attributes benefit on a straight-line basis under paragraph 68. Service beyond 20 years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first 20 years is 2,5 % of the present value of the expected medical costs (50 % divided by 20).

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For employees expected to leave between 10 and 20 years, the benefit attributed to each of the first 10 years is 1 % of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the 10th year and the estimated date of leaving.

For employees expected to leave within 10 years, no benefit is attributed.

71. Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the balance sheet date, but do not create an additional obligation. Therefore:
- (a) for the purpose of paragraph 67(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and
  - (b) the amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked.

**Example illustrating paragraph 71**

Employees are entitled to a benefit of 3 % of final salary for each year of service before the age of 55.

Benefit of 3 % of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

**Actuarial assumptions**

72. **Actuarial assumptions should be unbiased and mutually compatible.**
73. Actuarial assumptions are an enterprise's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise:
- (a) demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:
    - (i) mortality, both during and after employment;
    - (ii) rates of employee turnover, disability and early retirement;
    - (iii) the proportion of plan members with dependants who will be eligible for benefits; and
    - (iv) claim rates under medical plans; and
  - (b) financial assumptions, dealing with items such as:
    - (i) the discount rate (see paragraphs 78 to 82);
    - (ii) future salary and benefit levels (see paragraphs 83 to 87);
    - (iii) in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments (see paragraphs 88 to 91); and
    - (iv) the expected rate of return on plan assets (see paragraphs 105 to 107).
74. Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.

75. Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, the return on plan assets and discount rates. For example, all assumptions which depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.
76. An enterprise determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation-adjusted) terms are more reliable, for example, in a hyperinflationary economy (see IAS 29, financial reporting in hyperinflationary economies), or where the benefit is index-linked and there is a deep market in index-linked bonds of the same currency and term.
77. **Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations are to be settled.**

Actuarial assumptions: discount rate

78. **The rate used to discount post-employment benefit obligations (both funded and unfunded) should be determined by reference to market yields at the balance sheet date on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the balance sheet date) on government bonds should be used. The currency and term of the corporate bonds or government bonds should be consistent with the currency and estimated term of the post-employment benefit obligations.**
79. One actuarial assumption which has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the enterprise-specific credit risk borne by the enterprise's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions.
80. The discount rate reflects the estimated timing of benefit payments. In practice, an enterprise often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid.
81. In some cases, there may be no deep market in bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such cases, an enterprise uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available corporate or government bonds.
82. Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period, taking account of any material changes in the obligation. The present value of the obligation will differ from the liability recognised in the balance sheet because the liability is recognised after deducting the fair value of any plan assets and because some actuarial gains and losses, and some past service cost, are not recognised immediately. (Appendix A illustrates the computation of interest cost, among other things.)

Actuarial assumptions: salaries, benefits and medical costs

83. **Post-employment benefit obligations should be measured on a basis that reflects:**
- (a) **estimated future salary increases;**
- (b) **the benefits set out in the terms of the plan (or resulting from any constructive obligation that goes beyond those terms) at the balance sheet date; and**

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- (c) **estimated future changes in the level of any State benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:**
- (i) **those changes were enacted before the balance sheet date; or**
  - (ii) **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.**
84. Estimates of future salary increases take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.
85. If the formal terms of a plan (or a constructive obligation that goes beyond those terms) require an enterprise to change benefits in future periods, the measurement of the obligation reflects those changes. This is the case when, for example:
- (a) the enterprise has a past history of increasing benefits, for example, to mitigate the effects of inflation, and there is no indication that this practice will change in the future; or
  - (b) actuarial gains have already been recognised in the financial statements and the enterprise is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants (see paragraph 98(c)).
86. Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the balance sheet date. Such changes will result in:
- (a) past service cost, to the extent that they change benefits for service before the change; and
  - (b) current service cost for periods after the change, to the extent that they change benefits for service after the change.
87. Some post-employment benefits are linked to variables such as the level of State retirement benefits or State medical care. The measurement of such benefits reflects expected changes in such variables, based on past history and other reliable evidence.
88. **Assumptions about medical costs should take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.**
89. Measurement of post-employment medical benefits requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An enterprise estimates future medical costs on the basis of historical data about the enterprise's own experience, supplemented where necessary by historical data from other enterprises, insurance companies, medical providers or other sources. Estimates of future medical costs consider the effect of technological advances, changes in health care utilisation or delivery patterns and changes in the health status of plan participants.
90. The level and frequency of claims is particularly sensitive to the age, health status and sex of employees (and their dependants) and may be sensitive to other factors such as geographical location. Therefore, historical data is adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the historical data. It is also adjusted where there is reliable evidence that historical trends will not continue.
91. Some post-employment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the balance sheet date (or based on any constructive obligation that goes beyond those terms).

Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from State or other medical providers (see paragraphs 83(c) and 87).

#### Actuarial gains and losses

92. ***In measuring its defined benefit liability under paragraph 54, an enterprise should, subject to paragraph 58A, recognise a portion (as specified in paragraph 93) of its actuarial gains and losses as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceeded the greater of:***
- (a) ***10 % of the present value of the defined benefit obligation at that date (before deducting plan assets); and***
  - (b) ***10 % of the fair value of any plan assets at that date.***

***These limits should be calculated and applied separately for each defined benefit plan.***

93. ***The portion of actuarial gains and losses to be recognised for each defined benefit plan is the excess determined under paragraph 92, divided by the expected average remaining working lives of the employees participating in that plan. However, an enterprise may adopt any systematic method that results in faster recognition of actuarial gains and losses, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. An enterprise may apply such systematic methods to actuarial gains and losses even if they fall within the limits specified in paragraph 92.***
94. Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. Causes of actuarial gains and losses include, for example:
- (a) unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;
  - (b) the effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;
  - (c) the effect of changes in the discount rate; and
  - (d) differences between the actual return on plan assets and the expected return on plan assets (see paragraphs 105 to 107).

95. In the long term, actuarial gains and losses may offset one another. Therefore, estimates of post-employment benefit obligations are best viewed as a range (or 'corridor') around the best estimate. An enterprise is permitted, but not required, to recognise actuarial gains and losses that fall within that range. This Standard requires an enterprise to recognise, as a minimum, a specified portion of the actuarial gains and losses that fall outside a 'corridor' of plus or minus 10 %. (Appendix A illustrates the treatment of actuarial gains and losses, among other things.) The Standard also permits systematic methods of faster recognition, provided that those methods satisfy the conditions set out in paragraph 93. Such permitted methods include, for example, immediate recognition of all actuarial gains and losses, both within and outside the 'corridor'. Paragraph 155(b)(iii) explains the need to consider any unrecognised part of the transitional liability in accounting for subsequent actuarial gains.

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## Past service cost

96. ***In measuring its defined benefit liability under paragraph 54, an enterprise should, subject to paragraph 58A, recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an enterprise should recognise past service cost immediately.***
97. Past service cost arises when an enterprise introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, past service cost is recognised over that period, regardless of the fact that the cost refers to employee service in previous periods. Past service cost is measured as the change in the liability resulting from the amendment (see paragraph 64).

## Example illustrating paragraph 97

An enterprise operates a pension plan that provides a pension of 2 % of final salary for each year of service. The benefits become vested after five years of service. On 1 January 20X5 the enterprise improves the pension to 2,5 % of final salary for each year of service starting from 1 January 20X1. At the date of the improvement, the present value of the additional benefits for service from 1 January 20X1 to 1 January 20X5 is as follows:

Employees with more than five years' service at 1/1/X5	150
Employees with less than five years' service at 1/1/X5 (average period until vesting: three years)	<u>120</u>
	<u>270</u>

The enterprise recognises 150 immediately because those benefits are already vested. The enterprise recognises 120 on a straight-line basis over three years from 1 January 20X5.

98. Past service cost excludes:
- (a) the effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);
  - (b) under and over estimates of discretionary pension increases where an enterprise has a constructive obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);
  - (c) estimates of benefit improvements that result from actuarial gains that have already been recognised in the financial statements if the enterprise is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (the resulting increase in the obligation is an actuarial loss and not past service cost, see paragraph 85(b));
  - (d) the increase in vested benefits when, in the absence of new or improved benefits, employees complete vesting requirements (there is no past service cost because the estimated cost of benefits was recognised as current service cost as the service was rendered); and

- (e) the effect of plan amendments that reduce benefits for future service (a curtailment).
99. An enterprise establishes the amortisation schedule for past service cost when the benefits are introduced or changed. It would be impracticable to maintain the detailed records needed to identify and implement subsequent changes in that amortisation schedule. Moreover, the effect is likely to be material only where there is a curtailment or settlement. Therefore, an enterprise amends the amortisation schedule for past service cost only if there is a curtailment or settlement.
100. Where an enterprise reduces benefits payable under an existing defined benefit plan, the resulting reduction in the defined benefit liability is recognised as (negative) past service cost over the average period until the reduced portion of the benefits becomes vested.
101. Where an enterprise reduces certain benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the enterprise treats the change as a single net change.

#### Recognition and measurement: plan assets

#### Fair value of plan assets

102. The fair value of any plan assets is deducted in determining the amount recognised in the balance sheet under paragraph 54. When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).
103. Plan assets exclude unpaid contributions due from the reporting enterprise to the fund, as well as any non-transferable financial instruments issued by the enterprise and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.
104. Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 54 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

#### Reimbursements

- 104A. ***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 enterprise should recognise its right to reimbursement as a separate asset. The enterprise should measure the asset at fair value. In all other respects, an enterprise should treat that asset in the same way as plan assets. In the income statement, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.***
- 104B. Sometimes, an enterprise is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 7, are plan assets. An enterprise accounts for qualifying insurance policies in the same way as for all other plan assets and paragraph 104A does not apply (see paragraphs 39 to 42 and 104).

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- 104C. When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 104A deals with such cases: the enterprise recognises its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognised under paragraph 54; in all other respects, the enterprise treats that asset in the same way as plan assets. In particular, the defined benefit liability recognised under paragraph 54 is increased (reduced) to the extent that net cumulative actuarial gains (losses) on the defined benefit obligation and on the related reimbursement right remain unrecognised under paragraphs 92 and 93. Paragraph 120(c)(vii) requires the enterprise to disclose a brief description of the link between the reimbursement right and the related obligation.

## Example illustrating paragraphs 104A-C

Present value of obligation	1 241
Unrecognised actuarial gains	17
Liability recognised in balance sheet	1 258
Rights under insurance policies that exactly match the amount and timing of some of the benefits payable under the plan. Those benefits have a present value of 1 092.	1 092

The unrecognised actuarial gains of 17 are the net cumulative actuarial gains on the obligation and on the reimbursement rights.

- 104D. If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation, as described in paragraph 54 (subject to any reduction required if the reimbursement is not recoverable in full).

## Return on plan assets

105. The expected return on plan assets is one component of the expense recognised in the income statement. The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss; it is included with the actuarial gains and losses on the defined benefit obligation in determining the net amount that is compared with the limits of the 10 % 'corridor' specified in paragraph 92.
106. The expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation. The expected return on plan assets reflects changes in the fair value of plan assets held during the period as a result of actual contributions paid into the fund and actual benefits paid out of the fund.
107. In determining the expected and actual return on plan assets, an enterprise deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation.

## Example illustrating paragraph 106

At 1 January 20X1, the fair value of plan assets was 10 000 and net cumulative unrecognised actuarial gains were 760. On 30 June 20X1, the plan paid benefits of 1 900 and received contributions of 4 900. At 31 December 20X1, the fair value of plan assets was 15 000 and the present value of the defined benefit obligation was 14 792. Actuarial losses on the obligation for 20X1 were 60.

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At 1 January 20X1, the reporting enterprise made the following estimates, based on market prices at that date:

	(%)
Interest and dividend income, after tax payable by the fund	9,25
Realised and unrealised gains on plan assets (after tax)	2,00
Administration costs	<u>(1,00)</u>
Expected rate of return	<u>10,25</u>
For 20X1, the expected and actual return on plan assets are as follows:	
Return on 10 000 held for 12 months at 10,25 %	1 025
Return on 3 000 held for six months at 5 % (equivalent to 10,25 % annually, compounded every six months)	<u>150</u>
Expected return on plan assets for 20X1	<u>1 175</u>
Fair value of plan assets at 31 December 20X1	15 000
Less fair value of plan assets at 1 January 20X1	(10 000)
Less contributions received	(4 900)
Add benefits paid	<u>1 900</u>
Actual return on plan assets	<u>2 000</u>

The difference between the expected return on plan assets (1 175) and the actual return on plan assets (2 000) is an actuarial gain of 825. Therefore, the cumulative net unrecognised actuarial gains are 1 525 (760 plus 825 less 60). Under paragraph 92, the limits of the corridor are set at 1 500 (greater of: (i) 10 % of 15 000 and (ii) 10 % of 14 792). In the following year (20X2), the enterprise recognises in the income statement an actuarial gain of 25 (1 525 less 1 500) divided by the expected average remaining working life of the employees concerned. The expected return on plan assets for 20X2 will be based on market expectations at 1/1/X2 for returns over the entire life of the obligation.

#### Business combinations

108. In a business combination that is an acquisition, an enterprise recognises assets and liabilities arising from post-employment benefits at the present value of the obligation less the fair value of any plan assets (see IAS 22, business combinations). The present value of the obligation includes all of the following, even if the acquiree had not yet recognised them at the date of the acquisition:
- (a) actuarial gains and losses that arose before the date of the acquisition (whether or not they fell inside the 10 % 'corridor');
  - (b) past service cost that arose from benefit changes, or the introduction of a plan, before the date of the acquisition; and
  - (c) amounts that, under the transitional provisions of paragraph 155(b), the acquiree had not recognised.

#### Curtailments and settlements

109. **An enterprise should recognise gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss on a curtailment or settlement should comprise:**
- (a) **any resulting change in the present value of the defined benefit obligation;**

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- (b) *any resulting change in the fair value of the plan assets;*
  - (c) *any related actuarial gains and losses and past service cost that, under paragraphs 92 and 96, had not previously been recognised.*
110. ***Before determining the effect of a curtailment or settlement, an enterprise should remeasure the obligation (and the related plan assets, if any) using current actuarial assumptions (including current market interest rates and other current market prices).***
111. A curtailment occurs when an enterprise either:
- (a) is demonstrably committed to make a material reduction in the number of employees covered by a plan; or
  - (b) amends the terms of a defined benefit plan such that a material element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.

A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan. An event is material enough to qualify as a curtailment if the recognition of a curtailment gain or loss would have a material effect on the financial statements. Curtailments are often linked with a restructuring. Therefore, an enterprise accounts for a curtailment at the same time as for a related restructuring.

112. A settlement occurs when an enterprise enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan, for example, when a lump-sum cash payment is made to, or on behalf of, plan participants in exchange for their rights to receive specified post-employment benefits.
113. In some cases, an enterprise acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the enterprise retains a legal or constructive obligation (see paragraph 39) to pay further amounts if the insurer does not pay the employee benefits specified in the insurance policy. Paragraphs 104A to D deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.
114. A settlement occurs together with a curtailment if a plan is terminated such that the obligation is settled and the plan ceases to exist. However, the termination of a plan is not a curtailment or settlement if the plan is replaced by a new plan that offers benefits that are, in substance, identical.
115. Where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the previously unrecognised past service cost and actuarial gains and losses (and of transitional amounts remaining unrecognised under paragraph 155(b)). The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement, unless another basis is more rational in the circumstances. For example, it may be appropriate to apply any gain arising on a curtailment or settlement of the same plan to first eliminate any unrecognised past service cost relating to the same plan.

Example illustrating paragraph 115

An enterprise discontinues a business segment and employees of the discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the enterprise has a defined benefit obligation with a net present value of 1 000, plan assets with a fair value of 820 and net cumulative unrecognised actuarial gains of 50. The enterprise had first adopted the Standard one year before. This increased the net liability by 100, which the enterprise chose to recognise over five years (see paragraph 155(b)). The curtailment reduces the net present value of the obligation by 100 to 900.

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Of the previously unrecognised actuarial gains and transitional amounts, 10 % (100/1 000) relates to the part of the obligation that was eliminated through the curtailment. Therefore, the effect of the curtailment is as follows:

	Before curtailment	Curtailment gain	After curtailment
Net present value of obligation	1 000	(100)	900
Fair value of plan assets	(820)	—	(820)
	180	(100)	80
Unrecognised actuarial gains	50	(5)	45
Unrecognised transitional amount ( $100 \times \frac{4}{5}$ )	(80)	8	(72)
Net liability recognised in balance sheet	150	(97)	53

*Presentation**Offset*

116. **An enterprise should offset an asset relating to one plan against a liability relating to another plan when, and only when, the enterprise:**

- (a) **has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and**
- (b) **intends either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.**

117. The offsetting criteria are similar to those established for financial instruments in IAS 32, financial instruments: disclosure and presentation.

*Current/non-current distinction*

118. Some enterprises distinguish current assets and liabilities from non-current assets and liabilities. This Standard does not specify whether an enterprise should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits.

*Financial components of post-employment benefit costs*

119. This Standard does not specify whether an enterprise should present current service cost, interest cost and the expected return on plan assets as components of a single item of income or expense on the face of the income statement.

*Disclosure*

120. **An enterprise should disclose the following information about defined benefit plans:**

- (a) **the enterprise's accounting policy for recognising actuarial gains and losses;**
- (b) **a general description of the type of plan;**

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- (c) *a reconciliation of the assets and liabilities recognised in the balance sheet, showing at least:*
- (i) *the present value at the balance sheet date of defined benefit obligations that are wholly unfunded;*
  - (ii) *the present value (before deducting the fair value of plan assets) at the balance sheet date of defined benefit obligations that are wholly or partly funded;*
  - (iii) *the fair value of any plan assets at the balance sheet date;*
  - (iv) *the net actuarial gains or losses not recognised in the balance sheet (see paragraph 92);*
  - (v) *the past service cost not yet recognised in the balance sheet (see paragraph 96);*
  - (vi) *any amount not recognised as an asset, because of the limit in paragraph 58(b);*
  - (vii) *the fair value at the balance sheet date of any reimbursement right recognised as an asset under paragraph 104A (with a brief description of the link between the reimbursement right and the related obligation); and*
  - (viii) *the other amounts recognised in the balance sheet;*
- (d) *the amounts included in the fair value of plan assets for:*
- (i) *each category of the reporting enterprise's own financial instruments; and*
  - (ii) *any property occupied by, or other assets used by, the reporting enterprise;*
- (e) *a reconciliation showing the movements during the period in the net liability (or asset) recognised in the balance sheet;*
- (f) *the total expense recognised in the income statement for each of the following, and the line item(s) of the income statement in which they are included:*
- (i) *current service cost;*
  - (ii) *interest cost;*
  - (iii) *expected return on plan assets;*
  - (iv) *expected return on any reimbursement right recognised as an asset under paragraph 104A;*
  - (v) *actuarial gains and losses;*
  - (vi) *past service cost; and*
  - (vii) *the effect of any curtailment or settlement;*
- (g) *the actual return on plan assets, as well as the actual return on any reimbursement right recognised as an asset under paragraph 104A; and*
- (h) *the principal actuarial assumptions used as at the balance sheet date, including, where 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 return for the periods presented in the financial statements on any reimbursement right recognised as an asset under paragraph 104A;*
- (iv) *the expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a plan as the basis for future benefit increases);*
- (v) *medical cost trend rates; and*
- (vi) *any other material actuarial assumptions used.*

*An enterprise should disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables.*

121. Paragraph 120(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans and from post-employment medical plans. Further detail is not required.
122. When an enterprise has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:
- (a) the geographical location of the plans, for example, by distinguishing domestic plans from foreign plans; or
  - (b) whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans and from post-employment medical plans.

When an enterprise provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

123. Paragraph 30 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.
124. Where required by IAS 24, related party disclosures, an enterprise discloses information about:
- (a) related party transactions with post-employment benefit plans; and
  - (b) post-employment benefits for key management personnel.
125. Where required by IAS 37, provisions, contingent liabilities and contingent assets, an enterprise discloses information about contingent liabilities arising from post-employment benefit obligations.

#### OTHER LONG-TERM EMPLOYEE BENEFITS

126. Other long-term employee benefits include, for example:
- (a) long-term compensated absences such as long-service or sabbatical leave;
  - (b) jubilee or other long-service benefits;
  - (c) long-term disability benefits;
  - (d) profit-sharing and bonuses payable 12 months or more after the end of the period in which the employees render the related service; and
  - (e) deferred compensation paid 12 months or more after the end of the period in which it is earned.

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127. The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Furthermore, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. For these reasons, this Standard requires a simplified method of accounting for other long-term employee benefits. This method differs from the accounting required for post-employment benefits as follows:

- (a) actuarial gains and losses are recognised immediately and no 'corridor' is applied; and
- (b) all past service cost is recognised immediately.

*Recognition and measurement*

128. ***The amount recognised as a liability for other long-term employee benefits should be the net total of the following amounts:***

- (a) ***the present value of the defined benefit obligation at the balance sheet date (see paragraph 64);***
- (b) ***minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102 to 104).***

***In measuring the liability, an enterprise should apply paragraphs 49 to 91, excluding paragraphs 54 and 61. An enterprise should apply paragraph 104A in recognising and measuring any reimbursement right.***

129. ***For other long-term employee benefits, an enterprise should recognise the net total of the following amounts as expense or (subject to paragraph 58) income, except to the extent that another International Accounting Standard requires or permits their inclusion in the cost of an asset:***

- (a) ***current service cost (see paragraphs 63 to 91);***
- (b) ***interest cost (see paragraph 82);***
- (c) ***the expected return on any plan assets (see paragraphs 105 to 107) and on any reimbursement right recognised as an asset (see paragraph 104A);***
- (d) ***actuarial gains and losses, which should all be recognised immediately;***
- (e) ***past service cost, which should all be recognised immediately; and***
- (f) ***the effect of any curtailments or settlements (see paragraphs 109 and 110).***

130. One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

*Disclosure*

131. Although this Standard does not require specific disclosures about other long-term employee benefits, other International Accounting Standards may require disclosures, for example, where the expense resulting from such benefits is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period (see IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies). Where required by IAS 24, related party disclosures, an enterprise discloses information about other long-term employee benefits for key management personnel.

## TERMINATION BENEFITS

132. This Standard deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination rather than employee service.

*Recognition*

133. **An enterprise should recognise termination benefits as a liability and an expense when, and only when, the enterprise is demonstrably committed to either:**
- (a) **terminate the employment of an employee or group of employees before the normal retirement date; or**
  - (b) **provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.**
134. **An enterprise is demonstrably committed to a termination when, and only when, the enterprise has a detailed formal plan for the termination and is without realistic possibility of withdrawal. The detailed plan should include, as a minimum:**
- (a) **the location, function, and approximate number of employees whose services are to be terminated;**
  - (b) **the termination benefits for each job classification or function; and**
  - (c) **the time at which the plan will be implemented. Implementation should begin as soon as possible and the period of time to complete implementation should be such that material changes to the plan are not likely.**
135. An enterprise 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. Termination benefits are typically lump-sum payments, but sometimes also include:
- (a) enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and
  - (b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the enterprise.
136. Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits are described in some countries as termination indemnities, or termination gratuities, they are post-employment benefits, rather than termination benefits and an enterprise accounts for them as post-employment benefits. Some enterprises provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the enterprise. The additional benefit payable on involuntary termination is a termination benefit.
137. Termination benefits do not provide an enterprise with future economic benefits and are recognised as an expense immediately.
138. Where an enterprise recognises termination benefits, the enterprise may also have to account for a curtailment of retirement benefits or other employee benefits (see paragraph 109).

**IAS 19***Measurement*

139. **Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted using the discount rate specified in paragraph 78.**
140. **In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.**

*Disclosure*

141. Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. As required by IAS 37, provisions, contingent liabilities and contingent assets, an enterprise discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.
142. As required by IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, an enterprise discloses the nature and amount of an expense if it is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period. Termination benefits may result in an expense needing disclosure in order to comply with this requirement.
143. Where required by IAS 24, related party disclosures, an enterprise discloses information about termination benefits for key management personnel.

## EQUITY COMPENSATION BENEFITS

144. Equity compensation benefits include benefits in such forms as:
- (a) shares, share options, and other equity instruments, issued to employees at less than the fair value at which those instruments would be issued to a third party; and
  - (b) cash payments, the amount of which will depend on the future market price of the reporting enterprise's shares.

*Recognition and measurement*

145. This Standard does not specify recognition and measurement requirements for equity compensation benefits.

*Disclosure*

146. The disclosures required below are intended to enable users of financial statements to assess the effect of equity compensation benefits on an enterprise's financial position, performance and cash flows. Equity compensation benefits may affect:
- (a) an enterprise's financial position by requiring the enterprise to issue equity financial instruments or convert financial instruments, for example, when employees, or employee compensation plans, hold share options or have partially satisfied the vesting provisions that will enable them to acquire share options in the future; and
  - (b) an enterprise's performance and cash flows by reducing the amount of cash or other employee benefits that the enterprise provides to employees in exchange for their services.

**147. An enterprise should disclose:**

- (a) *the nature and terms (including any vesting provisions) of equity compensation plans;*
- (b) *the accounting policy for equity compensation plans;*
- (c) *the amounts recognised in the financial statements for equity compensation plans;*
- (d) *the number and terms (including, where applicable, dividend and voting rights, conversion rights, exercise dates, exercise prices and expiry dates) of the enterprise's own equity financial instruments which are held by equity compensation plans (and, in the case of share options, by employees) at the beginning and end of the period. The extent to which employees' entitlements to those instruments are vested at the beginning and end of the period should be specified;*
- (e) *the number and terms (including, where applicable, dividend and voting rights, conversion rights, exercise dates, exercise prices and expiry dates) of equity financial instruments issued by the enterprise to equity compensation plans or to employees (or of the enterprise's own equity financial instruments distributed by equity compensation plans to employees) during the period and the fair value of any consideration received from the equity compensation plans or the employees;*
- (f) *the number, exercise dates and exercise prices of share options exercised under equity compensation plans during the period;*
- (g) *the number of share options held by equity compensation plans, or held by employees under such plans, that lapsed during the period; and*
- (h) *the amount, and principal terms, of any loans or guarantees granted by the reporting enterprise to, or on behalf of, equity compensation plans.*

**148. An enterprise should also disclose:**

- (a) *the fair value, at the beginning and end of the period, of the enterprise's own equity financial instruments (other than share options) held by equity compensation plans; and*
- (b) *the fair value, at the date of issue, of the enterprise's own equity financial instruments (other than share options) issued by the enterprise to equity compensation plans or to employees, or by equity compensation plans to employees, during the period.*

*If it is not practicable to determine the fair value of the equity financial instruments (other than share options), that fact should be disclosed.*

149. When an enterprise has more than one equity compensation plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered most useful for assessing the enterprise's obligations to issue equity financial instruments under such plans and the changes in those obligations during the current period. Such groupings may distinguish, for example, the location and seniority of the employee groups covered. When an enterprise provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

150. When an enterprise has issued share options to employees, or to employee compensation plans, disclosures may be made in total, or in such groupings as are considered most useful for assessing the number and timing of shares that may be issued and the cash that may be received as a result. For example, it may be useful to distinguish options that are 'out-of-the-money' (where the exercise price exceeds the current market price) from options that are 'in-the-money' (where the current market price exceeds the exercise price). Furthermore, it may be useful to combine the disclosures in groupings that do not aggregate options with a wide range of exercise prices or exercise dates.

**IAS 19**

151. The disclosures required by paragraphs 147 and 148 are intended to meet the objectives of this Standard. Additional disclosure may be required to satisfy the requirements of IAS 24, related party disclosures, if an enterprise:
- (a) provides equity compensation benefits to key management personnel;
  - (b) provides equity compensation benefits in the form of instruments issued by the enterprise's parent; or
  - (c) enters into related party transactions with equity compensation plans.
152. In the absence of specific recognition and measurement requirements for equity compensation plans, information about the fair value of the reporting enterprise's financial instruments used in such plans is useful to users of financial statements. However, because there is no consensus on the appropriate way to determine the fair value of share options, this Standard does not require an enterprise to disclose their fair value.

## TRANSITIONAL PROVISIONS

153. This section specifies the transitional treatment for defined benefit plans. Where an enterprise first adopts this Standard for other employee benefits, the enterprise applies IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies.
154. ***On first adopting this Standard, an enterprise should determine its transitional liability for defined benefit plans at that date as:***
- (a) ***the present value of the obligation (see paragraph 64) at the date of adoption;***
  - (b) ***minus the fair value, at the date of adoption, of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102 to 104);***
  - (c) ***minus any past service cost that, under paragraph 96, should be recognised in later periods.***
155. ***If the transitional liability is more than the liability that would have been recognised at the same date under the enterprise's previous accounting policy, the enterprise should make an irrevocable choice to recognise that increase as part of its defined benefit liability under paragraph 54:***
- (a) ***immediately, under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies; or***
  - (b) ***as an expense on a straight-line basis over up to five years from the date of adoption. If an enterprise chooses (b), the enterprise should:***
    - (i) ***apply the limit described in paragraph 58(b) in measuring any asset recognised in the balance sheet;***
    - (ii) ***disclose at each balance sheet date: (1) the amount of the increase that remains unrecognised; and (2) the amount recognised in the current period;***
    - (iii) ***limit the recognition of subsequent actuarial gains (but not negative past service cost) as follows. If an actuarial gain is to be recognised under paragraphs 92 and 93, an enterprise should recognise that actuarial gain only to the extent that the net cumulative unrecognised actuarial gains (before recognition of that actuarial gain) exceed the unrecognised part of the transitional liability; and***
    - (iv) ***include the related part of the unrecognised transitional liability in determining any subsequent gain or loss on settlement or curtailment.***

***If the transitional liability is less than the liability that would have been recognised at the same date under the enterprise's previous accounting policy, the enterprise should recognise that decrease immediately under IAS 8.***

156. On the initial adoption of the Standard, the effect of the change in accounting policy includes all actuarial gains and losses that arose in earlier periods even if they fall inside the 10 % 'corridor' specified in paragraph 92.

Example illustrating paragraphs 154 to 156

At 31 December 1998, an enterprise's balance sheet includes a pension liability of 100. The enterprise adopts the Standard as of 1 January 1999, when the present value of the obligation under the Standard is 1 300 and the fair value of plan assets is 1 000. On 1 January 1993, the enterprise had improved pensions (cost for non-vested benefits: 160; and average remaining period at that date until vesting: 10 years).

The transitional effect is as follows:

Present value of the obligation	1 300
Fair value of plan assets	(1 000)
Less: past service cost to be recognised in later periods ( $160 \times 4/10$ )	<u>(64)</u>
Transitional liability	236
Liability already recognised	<u>100</u>
Increase in liability	<u>136</u>

The enterprise may choose to recognise the increase of 136 either immediately or over up to 5 years. The choice is irrevocable.

At 31 December 1999, the present value of the obligation under the Standard is 1 400 and the fair value of plan assets is 1 050. Net cumulative unrecognised actuarial gains since the date of adopting the Standard are 120. The expected average remaining working life of the employees participating in the plan was eight years. The enterprise has adopted a policy of recognising all actuarial gains and losses immediately, as permitted by paragraph 93.

The effect of the limit in paragraph 155(b)(iii) is as follows.

Net cumulative unrecognised actuarial gains	120
Unrecognised part of transitional liability ( $136 \times 4/5$ )	<u>(109)</u>
Maximum gain to be recognised (paragraph 155(b)(iii))	<u>11</u>

EFFECTIVE DATE

157. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999, except as specified in paragraphs 159 and 159A. Earlier adoption is encouraged. If an enterprise applies this Standard to retirement benefit costs for financial statements covering periods beginning before 1 January 1999, the enterprise should disclose the fact that it has applied this Standard instead of IAS 19, retirement benefit costs, approved in 1993.***
158. This Standard supersedes IAS 19, retirement benefit costs, approved in 1993.
159. ***The following become operative for annual financial statements<sup>(2)</sup> covering periods beginning on or after 1 January 2001:***
- (a) ***the revised definition of plan assets in paragraph 7 and the related definitions of assets held by a long-term employee benefit fund and qualifying insurance policy; and***

<sup>(2)</sup> Paragraphs 159 and 159A refer to 'annual financial statements' in line with more explicit language for writing effective dates adopted in 1998. Paragraph 157 refers to 'financial statements'.

**IAS 20**

- (b) *the recognition and measurement requirements for reimbursements in paragraphs 104A, 128 and 129 and related disclosures in paragraphs 120(c)(vii), 120(f)(iv), 120(g) and 120(h)(iii).*

*Earlier adoption is encouraged. If earlier adoption affects the financial statements, an enterprise should disclose that fact.*

- 159A. *The amendment in paragraph 58A becomes operative for annual financial statements<sup>(3)</sup> covering periods ending on or after 31 May 2002. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an enterprise should disclose that fact.*
160. IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, applies when an enterprise changes its accounting policies to reflect the changes specified in paragraphs 159 and 159A. In applying those changes retrospectively, as required by the benchmark and allowed alternative treatments in IAS 8, the enterprise treats those changes as if they had been adopted at the same time as the rest of this Standard.

**INTERNATIONAL ACCOUNTING STANDARD IAS 20  
(REFORMATTED 1994)**

**Accounting for government grants and disclosure of government assistance**

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in November 1982. It is presented in the revised format adopted for International Accounting Standards in 1991 onwards. No substantive changes have been made to the original approved text. Certain terminology has been changed to bring it into line with current IASC practice.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 11. The amended text was effective for financial statements covering annual periods beginning on or after 1 January 2000.

In January 2001, IAS 41, agriculture, amended paragraph 2. The amended text becomes effective for financial statements covering annual periods beginning on or after 1 January 2003.

One SIC interpretation relates to IAS 20:

- SIC-10: government assistance — no specific relation to operating activities.

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<sup>(3)</sup> Paragraphs 159 and 159A refer to 'annual financial statements' in line with more explicit language for writing effective dates adopted in 1998. Paragraph 157 refers to 'financial statements'.

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The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the 'Preface to International Accounting Standards'. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

## SCOPE

1. ***This Standard should be applied in accounting for, and in the disclosure of, government grants and in the disclosure of other forms of government assistance.***
2. This Standard does not deal with:
  - (a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;
  - (b) government assistance that is provided for an enterprise in the form of benefits that are available in determining taxable income or are determined or limited on the basis of income tax liability (such as income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates);
  - (c) government participation in the ownership of the enterprise;
  - (d) government grants covered by IAS 41, agriculture.

## DEFINITIONS

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

***Government refers to government, government agencies and similar bodies whether local, national or international.***

***Government assistance is action by government designed to provide an economic benefit specific to an enterprise or range of enterprises qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.***

***Government grants are assistance by government in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise<sup>(1)</sup>.***

***Grants related to assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.***

<sup>(1)</sup> See also SIC — 10: government assistance — no specific relation to operating activities.

## IAS 20

*Grants related to income are government grants other than those related to assets.*

*Forgivable loans are loans which the lender undertakes to waive repayment of under certain prescribed conditions.*

*Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.*

4. Government assistance takes many forms varying both in the nature of the assistance given and in the conditions which are usually attached to it. The purpose of the assistance may be to encourage an enterprise to embark on a course of action which it would not normally have taken if the assistance was not provided.
5. The receipt of government assistance by an enterprise may be significant for the preparation of the financial statements for two reasons. Firstly, if resources have been transferred, an appropriate method of accounting for the transfer must be found. Secondly, it is desirable to give an indication of the extent to which the enterprise has benefited from such assistance during the reporting period. This facilitates comparison of an enterprise's financial statements with those of prior periods and with those of other enterprises.
6. Government grants are sometimes called by other names such as subsidies, subventions, or premiums.

## GOVERNMENT GRANTS

7. ***Government grants, including non-monetary grants at fair value, should not be recognised until there is reasonable assurance that:***
  - (a) ***the enterprise will comply with the conditions attaching to them; and***
  - (b) ***the grants will be received.***
8. A government grant is not recognised until there is reasonable assurance that the enterprise will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.
9. The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government.
10. A forgivable loan from government is treated as a government grant when there is reasonable assurance that the enterprise will meet the terms for forgiveness of the loan.
11. Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with IAS 37, provisions, contingent liabilities and contingent assets.
12. ***Government grants should be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. They should not be credited directly to shareholders' interests.***
13. Two broad approaches may be found to the accounting treatment of government grants: the capital approach, under which a grant is credited directly to shareholders' interests, and the income approach, under which a grant is taken to income over one or more periods.
14. Those in support of the capital approach argue as follows:
  - (a) government grants are a financing device and should be dealt with as such in the balance sheet rather than be passed through the income statement to offset the items of expense which they finance. Since no repayment is expected, they should be credited directly to shareholders' interests; and

- (b) it is inappropriate to recognise government grants in the income statement, since they are not earned but represent an incentive provided by government without related costs.
15. Arguments in support of the income approach are as follows:
- (a) since government grants are receipts from a source other than shareholders, they should not be credited directly to shareholders' interests but should be recognised as income in appropriate periods;
- (b) government grants are rarely gratuitous. The enterprise earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised as income and matched with the associated costs which the grant is intended to compensate; and
- (c) as income and other taxes are charges against income, it is logical to deal also with government grants, which are an extension of fiscal policies, in the income statement.
16. It is fundamental to the income approach that government grants be recognised as income on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption (see IAS 1, presentation of financial statements) and would only be acceptable if no basis existed for allocating a grant to periods other than the one in which it was received.
17. In most cases the periods over which an enterprise recognises the costs or expenses related to a government grant are readily ascertainable and thus grants in recognition of specific expenses are recognised as income in the same period as the relevant expense. Similarly, grants related to depreciable assets are usually recognised as income over the periods and in the proportions in which depreciation on those assets is charged.
18. Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised as income over the periods which bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise it as income over the life of the building.
19. Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached. In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another.
20. ***A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the enterprise with no future related costs should be recognised as income of the period in which it becomes receivable, as an extraordinary item if appropriate (see IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies).***
21. In certain circumstances, a government grant may be awarded for the purpose of giving immediate financial support to an enterprise rather than as an incentive to undertake specific expenditures. Such grants may be confined to an individual enterprise and may not be available to a whole class of beneficiaries. These circumstances may warrant recognising a grant as income in the period in which the enterprise qualifies to receive it, as an extraordinary item if appropriate, with disclosure to ensure that its effect is clearly understood.
22. A government grant may become receivable by an enterprise as compensation for expenses or losses incurred in a previous accounting period. Such a grant is recognised as income of the period in which it becomes receivable, as an extraordinary item if appropriate, with disclosure to ensure that its effect is clearly understood.

**IAS 20***Non-monetary government grants*

23. A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the enterprise. In these circumstances it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

*Presentation of grants related to assets*

24. **Government grants related to assets, including non-monetary grants at fair value, should be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.**
25. Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to assets are regarded as acceptable alternatives.
26. One method sets up the grant as deferred income which is recognised as income on a systematic and rational basis over the useful life of the asset.
27. The other method deducts the grant in arriving at the carrying amount of the asset. The grant is recognised as income over the life of a depreciable asset by way of a reduced depreciation charge.
28. The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an enterprise. For this reason and in order to show the gross investment in assets, such movements are often disclosed as separate items in the cash flow statement regardless of whether or not the grant is deducted from the related asset for the purpose of balance sheet presentation.

*Presentation of grants related to income*

29. Grants related to income are sometimes presented as a credit in the income statement, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.
30. Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method it is argued that the expenses might well not have been incurred by the enterprise if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.
31. Both methods are regarded as acceptable for the presentation of grants related to income. Disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.

*Repayment of government grants*

32. **A government grant that becomes repayable should be accounted for as a revision to an accounting estimate (see IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies). Repayment of a grant related to income should be applied first against any unamortised deferred credit set up in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or where no deferred credit exists, the repayment should be recognised immediately as an expense. Repayment of a grant related to an asset should be recorded by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised to date as an expense in the absence of the grant should be recognised immediately as an expense.**

33. Circumstances giving rise to repayment of a grant related to an asset may require consideration to be given to the possible impairment of the new carrying amount of the asset.

#### GOVERNMENT ASSISTANCE

34. Excluded from the definition of government grants in paragraph 3 are certain forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.
35. Examples of assistance that cannot reasonably have a value placed upon them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the enterprise is a government procurement policy that is responsible for a portion of the enterprise's sales. The existence of the benefit might be unquestioned but any attempt to segregate the trading activities from government assistance could well be arbitrary.
36. The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements may not be misleading.
37. Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest.
38. In this Standard, government assistance does not include the provision of infrastructure by improvement to the general transport and communication network and the supply of improved facilities such as irrigation or water reticulation which is available on an ongoing indeterminate basis for the benefit of an entire local community.

#### DISCLOSURE

39. ***The following matters should be disclosed:***
- (a) ***the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;***
  - (b) ***the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the enterprise has directly benefited; and***
  - (c) ***unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.***

#### TRANSITIONAL PROVISIONS

40. ***An enterprise adopting the Standard for the first time should:***
- (a) ***comply with the disclosure requirements, where appropriate; and***
  - (b) ***either:***
    - (i) ***adjust its financial statements for the change in accounting policy in accordance with IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies; or***
    - (ii) ***apply the accounting provisions of the Standard only to grants or portions of grants becoming receivable or repayable after the effective date of the Standard.***

#### EFFECTIVE DATE

41. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1984.***