IAS 21

INTERNATIONAL ACCOUNTING STANDARD IAS 21 (REVISED 1993)

The effects of changes in foreign exchange rates

This revised International Accounting Standard supersedes IAS 21, accounting for the effects of changes in foreign exchange rates, and became effective for financial statements covering periods beginning on or after 1 January 1995.

IAS 21 does not deal with hedge accounting for foreign currency items (other than items that hedge a net investment in a foreign entity). IAS 39, financial instruments: recognition and measurement deals with this topic.

In 1998, paragraph 2 of IAS 21 was amended to refer to IAS 39, financial instruments: recognition and measurement.

In 1999, paragraph 46 was amended to replace references to IAS 10, contingencies and events occurring after the balance sheet date, by references to IAS 10 (revised 1999), events after the balance sheet date.

The following SIC interpretations relate to IAS 21:

— SIC-7: introduction of the euro,

— SIC-11: foreign exchange — capitalisation of losses resulting from severe currency devaluations,

— SIC-19: reporting currency — measurement and presentation of financial statements under IAS 21 and IAS 29,

— SIC-30: reporting currency — translation from measurement currency to presentation currency.

CONTENTS

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

An enterprise may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

SCOPE

1. ***This Standard should be applied:***

   (a) ***in accounting for transactions in foreign currencies; and***

   (b) ***in translating the financial statements of foreign operations that are included in the financial statements of the enterprise by consolidation, proportionate consolidation or by the equity method*** [1]***.***

2. This Standard does not deal with hedge accounting for foreign currency items other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in a foreign entity. Other aspects of hedge accounting, including the criteria to use hedge accounting, are dealt with in IAS 39, financial instruments: recognition and measurement.

3. This Standard supersedes IAS 21, accounting for the effects of changes in foreign exchange rates, approved in 1983.

4. This Standard does not specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Standard requires disclosure of the reason for using that currency. This Standard also requires disclosure of the reason for any change in the reporting currency [2].

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[1] See also SIC-7: introduction of the euro.
[2] See also SIC-19: reporting currency — measurement and presentation of financial statements under IAS 21 and IAS 29.

5. This Standard does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes [3].

6. This Standard does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see IAS 7, cash flow statements).

DEFINITIONS

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

Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

Foreign entity is a foreign operation, the activities of which are not an integral part of those of the reporting enterprise.

Reporting currency is the currency used in presenting the financial statements.

Foreign currency is a currency other than the reporting currency of an enterprise.

Exchange rate is the ratio for exchange of two currencies.

Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

Closing rate is the spot exchange rate at the balance sheet date.

Net investment in a foreign entity is the reporting enterprise's share in the net assets of that entity.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

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.

FOREIGN CURRENCY TRANSACTIONS

Initial recognition

8. A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

   (a) buys or sells goods or services whose price is denominated in a foreign currency;

   (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;

   (c) becomes a party to an unperformed foreign exchange contract; or

   (d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

[3] See also SIC-30: reporting currency — translation from measurement currency to presentation currency.

9. ***A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.***

10. The exchange rate at the date of the transaction is often referred to as the spot rate. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Reporting at subsequent balance sheet dates

11. ***At each balance sheet date:***

(a) ***foreign currency monetary items should be reported using the closing rate;***

(b) ***non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and***

(c) ***non-monetary items which are carried at fair value denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.***

12. The carrying amount of an item is determined in accordance with the relevant International Accounting Standards. For example, certain financial instruments and property, plant and equipment may be measured at fair value or at historical cost. Whether the carrying amount is determined based on historical cost or fair value, the amounts so determined for foreign currency items are then reported in the reporting currency in accordance with this Standard.

Recognition of exchange differences

13. Paragraphs 15 to 18 set out the accounting treatment required by this Standard in respect of exchange differences on foreign currency transactions. These paragraphs include the benchmark treatment for exchange differences that result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of assets invoiced in a foreign currency. The allowed alternative treatment for such exchange differences is set out in paragraph 21.

14. This Standard does not deal with hedge accounting for foreign currency items other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in a foreign entity. Other aspects of hedge accounting, including the criteria to use hedge accounting, are dealt with in IAS 39, financial instruments: recognition and measurement.

15. ***Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraphs 17 and 19.***

16. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

Net investment in a foreign entity

17. ***Exchange differences arising on a monetary item that, in substance, forms part of an enterprise's net investment in a foreign entity should be classified as equity in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as expenses in accordance with paragraph 37.***

18. An enterprise may have a monetary item that is receivable from, or payable to, a foreign entity. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension to, or deduction from, the enterprise's net investment in that foreign entity. Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

19. ***Exchange differences arising on a foreign currency liability accounted for as a hedge of an enterprise's net investment in a foreign entity should be classified as equity in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as expenses in accordance with paragraph 37.***

Allowed alternative treatment

20. The benchmark treatment for exchange differences dealt with in paragraph 21 is set out in paragraph 15.

21. ***Exchange differences may result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset invoiced in a foreign currency. Such exchange differences should be included in the carrying amount of the related asset, provided that the adjusted carrying amount does not exceed the lower of the replacement cost and the amount recoverable from the sale or use of the asset*** [4]**.**

22. Exchange differences are not included in the carrying amount of an asset when the enterprise is able to settle or hedge the foreign currency liability arising on the acquisition of the asset. However, exchange losses are part of the directly attributable costs of the asset when the liability cannot be settled and there is no practical means of hedging, for example when, as a result of exchange controls, there is a delay in obtaining foreign currency. Therefore, under the allowed alternative treatment, the cost of an asset invoiced in a foreign currency is regarded as the amount of reporting currency that the enterprise ultimately has to pay to settle its liabilities arising directly on the recent acquisition of the asset.

FINANCIAL STATEMENTS OF FOREIGN OPERATIONS

Classification of foreign operations

23. The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise. For this purpose, foreign operations are classified as either 'foreign operations that are integral to the operations of the reporting enterprise' or 'foreign entities'.

24. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. For example, such a foreign operation might only sell goods imported from the reporting enterprise and remit the proceeds to the reporting enterprise. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an almost immediate effect on the reporting enterprise's cash flow from operations. Therefore, the change in the exchange rate affects the individual monetary items held by the foreign operation rather than the reporting enterprise's net investment in that operation.

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[4] See also SIC-11: foreign exchange — capitalisation of losses resulting from severe currency devaluations.

25. In contrast, a foreign entity accumulates cash and other monetary items, incurs expenses, generates income and perhaps arranges borrowings, all substantially in its local currency. It may also enter into transactions in foreign currencies, including transactions in the reporting currency. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the foreign entity or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the foreign entity rather than the individual monetary and non-monetary items held by the foreign entity.

26. The following are indications that a foreign operation is a foreign entity rather than a foreign operation that is integral to the operations of the reporting enterprise:

(a) while the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise;

(b) transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;

(c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;

(d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;

(e) the foreign operation's sales are mainly in currencies other than the reporting currency; and

(f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation.

The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a foreign entity or an integral operation of the reporting enterprise may not be clear, and judgement is necessary to determine the appropriate classification.

Foreign operations that are integral to the operations of the reporting enterprise

27. ***The financial statements of a foreign operation that is integral to the operations of the reporting enterprise should be translated using the standards and procedures in paragraphs 8 to 22 as if the transactions of the foreign operation had been those of the reporting enterprise itself.***

28. The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. The cost and depreciation of property, plant and equipment is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred. The recoverable amount or realisable value of an asset is translated using the exchange rate that existed when the recoverable amount or net realisable value was determined. For example, when the net realisable value of an item of inventory is determined in a foreign currency, that value is translated using the exchange rate at the date as at which the net realisable value is determined. The rate used is therefore usually the closing rate. An adjustment may be required to reduce the

carrying amount of an asset in the financial statements of the reporting enterprise to its recoverable amount or net realisable value even when no such adjustment is necessary in the financial statements of the foreign operation. Alternatively, an adjustment in the financial statements of the foreign operation may need to be reversed in the financial statements of the reporting enterprise.

29. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Foreign entities

30. ***In translating the financial statements of a foreign entity for incorporation in its financial statements, the reporting enterprise should use the following procedures:***

(a) ***the assets and liabilities, both monetary and non-monetary, of the foreign entity should be translated at the closing rate;***

(b) ***income and expense items of the foreign entity should be translated at exchange rates at the dates of the transactions, except when the foreign entity reports in the currency of a hyperinflationary economy, in which case income and expense items should be translated at the closing rate; and***

(c) ***all resulting exchange differences should be classified as equity until the disposal of the net investment.***

31. For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate income and expense items of a foreign operation.

32. The translation of the financial statements of a foreign entity results in the recognition of exchange differences arising from:

(a) translating income and expense items at the exchange rates at the dates of transactions and assets and liabilities at the closing rate;

(b) translating the opening net investment in the foreign entity at an exchange rate different from that at which it was previously reported; and

(c) other changes to equity in the foreign entity.

These exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the foreign entity or the reporting enterprise. When a foreign entity is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.

33. Any goodwill arising on the acquisition of a foreign entity and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign entity are treated as either:

(a) assets and liabilities of the foreign entity and translated at the closing rate in accordance with paragraph 30; or

(b) assets and liabilities of the reporting entity which either are already expressed in the reporting currency or are non-monetary foreign currency items which are reported using the exchange rate at the date of the transaction in accordance with paragraph 1 (b).

34. The incorporation of the financial statements of a foreign entity in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra-group transactions of a subsidiary (see International Accounting Standards IAS 27, consolidated financial statements and accounting for investments in subsidiaries, and IAS 31, financial reporting of interests in joint ventures). However, an exchange difference arising on an intra-group monetary item, whether short-term or long-term, cannot be eliminated against a corresponding amount arising on other intra-group balances because the monetary item represents a commitment to convert one currency into another and exposes the reporting enterprise to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting enterprise, such an exchange difference continues to be recognised as income or an expense or, if it arises from the circumstances described in paragraphs 17 and 19, it is classified as equity until the disposal of the net investment.

35. When the financial statements of a foreign entity are drawn up to a different reporting date from that of the reporting enterprise, the foreign entity often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise. When it is impracticable to do this, IAS 27, consolidated financial statements and accounting for investments in subsidiaries, allows the use of financial statements drawn up to a different reporting date provided that the difference is no greater than three months. In such a case, the assets and liabilities of the foreign entity are translated at the exchange rate at the balance sheet date of the foreign entity. Adjustments are made when appropriate for significant movements in exchange rates up to the balance sheet date of the reporting enterprise in accordance with IAS 27, consolidated financial statements and accounting for investments in subsidiaries, and IAS 28, accounting for investments in associates.

36. ***The financial statements of a foreign entity that reports in the currency of a hyperinflationary economy should be restated in accordance with IAS 29, financial reporting in hyperinflationary economies, before they are translated into the reporting currency of the reporting enterprise. When the economy ceases to be hyperinflationary and the foreign entity discontinues the preparation and presentation of financial statements prepared in accordance with IAS 29, financial reporting in hyperinflationary economies, it should use the amounts expressed in the measuring unit current at the date of discontinuation as the historical costs for translation into the reporting currency of the reporting enterprise.***

Disposal of a foreign entity

37. ***On the disposal of a foreign entity, the cumulative amount of the exchange differences which have been deferred and which relate to that foreign entity should be recognised as income or as expenses in the same period in which the gain or loss on disposal is recognised.***

38. An enterprise may dispose of its interest in a foreign entity through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that entity. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a foreign entity does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

Change in the classification of a foreign operation

39. ***When there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.***

40. A change in the way in which a foreign operation is financed and operates in relation to the reporting enterprise may lead to a change in the classification of that foreign operation. When a foreign operation that is integral to the operations of the reporting enterprise is reclassified as a foreign entity, exchange differences arising on the translation of non-monetary assets at the date of the reclassification are classified as equity.

When a foreign entity is reclassified as a foreign operation that is integral to the operation of the reporting enterprise, the translated amounts for non-monetary items at the date of the change are treated as the historical cost for those items in the period of change and subsequent periods. Exchange differences which have been deferred are not recognised as income or expenses until the disposal of the operation.

ALL CHANGES IN FOREIGN EXCHANGE RATES

Tax Effects of Exchange Differences

41. Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects which are accounted for in accordance with IAS 12, income taxes.

DISCLOSURE

42. ***An enterprise should disclose:***

    (a) ***the amount of exchange differences included in the net profit or loss for the period;***

    (b) ***net exchange differences classified as equity as a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period; and***

    (c) ***the amount of exchange differences arising during the period which is included in the carrying amount of an asset in accordance with the allowed alternative treatment in paragraph 21.***

43. ***When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed*** [5]***.***

44. ***When there is a change in the classification of a significant foreign operation, an enterprise should disclose:***

    (a) ***the nature of the change in classification;***

    (b) ***the reason for the change;***

    (c) ***the impact of the change in classification on shareholders' equity; and***

    (d) ***the impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.***

45. ***An enterprise should disclose the method selected in accordance with paragraph 33 to translate goodwill and fair value adjustments arising on the acquisition of a foreign entity.***

46. An enterprise discloses the effect on foreign currency monetary items or on the financial statements of a foreign operation of a change in exchange rates occurring after the balance sheet date if the change is of such importance that non-disclosure would affect the ability of users of the financial statements to make proper evaluations and decisions (see IAS 10, events after the balance sheet date).

47. Disclosure is also encouraged of an enterprise's foreign currency risk management policy.

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[5] See also SIC-30: reporting currency — translation from measurement currency to presentation currency.

TRANSITIONAL PROVISIONS

48. ***On the first occasion that an enterprise applies this Standard, the enterprise should, except when the amount is not reasonably determinable, classify separately and disclose the cumulative balance, at the beginning of the period, of exchange differences deferred and classified as equity in previous periods.***

EFFECTIVE DATE

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

INTERNATIONAL ACCOUNTING STANDARD IAS 22 (REVISED 1998)

Business combinations

IAS 22, accounting for business combinations, was approved in November 1983.

In December 1993, IAS 22 was revised as part of the project on comparability and improvements of financial statements. It became IAS 22, business combinations (IAS 22 (revised 1993)).

In October 1996, paragraphs 39(i) and 69 of IAS 22 (i.e. paragraphs 39(i) and 85 of this Standard), were revised to be consistent with IAS 12 (revised 1996), income taxes. The revisions became operative for annual financial statements covering periods beginning on or after 1 January 1998.

In July 1998, various paragraphs of IAS 22 were revised to be consistent with IAS 36, impairment of assets, IAS 37, provisions, contingent liabilities and contingent assets, and IAS 38, intangible assets, and the treatment of negative goodwill was also revised. The revised Standard (IAS 22 (revised 1998)) became operative for annual financial statements covering periods beginning on or after 1 July 1999.

In October 1998, the IASC staff published separately a 'Basis for conclusions for IAS 38, intangible assets and IAS 22 (revised 1998)'. The portion of the Basis for conclusions that refers to the revisions made to IAS 22 in 1998 is included as Appendix A.

In 1999, paragraph 97 was amended to replace references to IAS 10, contingencies and events occurring after the balance sheet date, by references to IAS 10 (revised 1999), events after the balance sheet date. In addition, paragraphs 30 and 31(c) were amended to be consistent with IAS 10 (revised 1999). The amended text became effective for annual financial statements covering periods beginning on or after 1 January 2000.

The following SIC Interpretations relate to IAS 22:

— SIC-9: business combinations — classification either as acquisitions or unitings of interests,

— SIC-22: business combinations — subsequent adjustment of fair values and goodwill initially reported,

— SIC-28: business combinations — 'date of exchange' and fair value of equity instruments.

IAS 22

CONTENTS

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 business combinations. The Standard covers both an acquisition of one enterprise by another and also the rare situation of a uniting of interests when an acquirer cannot be identified. Accounting for an acquisition involves determination of the cost of the acquisition, allocation of the cost over the identifiable assets and liabilities of the enterprise being acquired and accounting for the resulting goodwill or negative goodwill, both at acquisition and subsequently. Other accounting issues include the determination of the minority interest amount, accounting for acquisitions which occur over a period of time, subsequent changes in the cost of acquisition or in the identification of assets and liabilities, and the disclosures required.

SCOPE

1. ***This Standard should be applied in accounting for business combinations.***

2. A business combination may be structured in a variety of ways which are determined for legal, taxation or other reasons. It may involve the purchase by an enterprise of the equity of another enterprise or the purchase of the net assets of a business enterprise. It may be effected by the issue of shares or by the transfer of cash, cash equivalents or other assets. The transaction may be between the shareholders of the combining enterprises or between one enterprise and the shareholders of the other enterprise. The business combination may involve the establishment of a new enterprise to have control over the combining enterprises, the transfer of the net assets of one or more of the combining enterprises to another enterprise or the dissolution of one or more of the combining enterprises. When the substance of the transaction is consistent with the definition of a business combination in this Standard, the accounting and disclosure requirements contained in this Standard are appropriate irrespective of the particular structure adopted for the combination.

3. A business combination may result in a parent-subsidiary relationship in which the acquirer is the parent and the acquiree a subsidiary of the acquirer. In such circumstances, the acquirer applies this Standard in its consolidated financial statements. It includes its interest in the acquiree in its separate financial statements as an investment in a subsidiary (see IAS 27, consolidated financial statements and accounting for investments in subsidiaries).

4. A business combination may involve the purchase of the net assets, including any goodwill, of another enterprise rather than the purchase of the shares in the other enterprise. Such a business combination does not result in a parent-subsidiary relationship. In such circumstances, the acquirer applies this Standard in its separate financial statements and consequently in its consolidated financial statements.

5. A business combination may give rise to a legal merger. While the requirements for legal mergers differ among countries, a legal merger is usually a merger between two companies in which either:

   (a) the assets and liabilities of one company are transferred to the other company and the first company is dissolved; or

   (b) the assets and liabilities of both companies are transferred to a new company and both the original companies are dissolved.

   Many legal mergers arise as part of the restructuring or reorganisation of a group and are not dealt with in this Standard because they are transactions among enterprises under common control. However, any business combination that resulted in the two companies becoming members of the same group is dealt with as an acquisition or as a uniting of interests in consolidated financial statements under the requirements of this Standard.

6. This Standard does not deal with the separate financial statements of a parent other than in the circumstances described in paragraph 4. Separate financial statements are prepared using different reporting practices in different countries in order to meet a variety of needs.

7. This Standard does not deal with:

   (a) transactions among enterprises under common control; and

   (b) interests in joint ventures (see IAS 31, financial reporting of interests in joint ventures) and the financial statements of joint ventures.

DEFINITIONS

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

   A business combination is the bringing together of separate enterprises into one economic entity as a result of one enterprise uniting with or obtaining control over the net assets and operations of another enterprise.

   An acquisition is a business combination in which one of the enterprises, the acquirer, obtains control over the net assets and operations of another enterprise, the acquiree, in exchange for the transfer of assets, incurrence of a liability or issue of equity.

   A uniting of interests is a business combination in which the shareholders of the combining enterprises combine control over the whole, or effectively the whole, of their net assets and operations to achieve a continuing mutual sharing in the risks and benefits attaching to the combined entity such that neither party can be identified as the acquirer.

   Control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

   A parent is an enterprise that has one or more subsidiaries.

   A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

   Minority interest is that part of the net results of operations and of net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries, by the parent.

***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.*

***Monetary assets** are money held and assets to be received in fixed or determinable amounts of money.*

***Date of acquisition** is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer.*

NATURE OF A BUSINESS COMBINATION

9. In accounting for a business combination, an acquisition is in substance different from a uniting of interests and the substance of the transaction needs to be reflected in the financial statements [1]. Accordingly, a different accounting method is prescribed for each.

Acquisitions

10. In virtually all business combinations one of the combining enterprises obtains control over the other combining enterprise, thereby enabling an acquirer to be identified. Control is presumed to be obtained when one of the combining enterprises acquires more than one half of the voting rights of the other combining enterprise unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Even when one of the combining enterprises does not acquire more than one half of the voting rights of the other combining enterprise, it may still be possible to identify an acquirer when one of the combining enterprises, as a result of the business combination, acquires:

   (a) power over more than one half of the voting rights of the other enterprise by virtue of an agreement with other investors;

   (b) power to govern the financial and operating policies of the other enterprise under a statute or an agreement;

   (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the other enterprise; or

   (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the other enterprise.

11. Although it may sometimes be difficult to identify an acquirer, there are usually indications that one exists. For example:

   (a) the fair value of one enterprise is significantly greater than that of the other combining enterprise. In such cases, the larger enterprise is the acquirer;

   (b) the business combination is effected through an exchange of voting common shares for cash. In such cases, the enterprise giving up cash is the acquirer; or

   (c) the business combination results in the management of one enterprise being able to dominate the selection of the management team of the resulting combined enterprise. In such cases the dominant enterprise is the acquirer.

Reverse acquisitions

12. Occasionally an enterprise obtains ownership of the shares of another enterprise but as part of the exchange transaction issues enough voting shares, as consideration, such that control of the combined enterprise passes to the owners of the enterprise whose shares have been acquired. This situation is described as a reverse acquisition. Although legally the enterprise issuing the shares may be regarded as the parent or continuing

[1] See also SIC-9: business combinations — classification either as acquisitions or unitings of interests.

enterprise, the enterprise whose shareholders now control the combined enterprise is the acquirer enjoying the voting or other powers identified in paragraph 10. The enterprise issuing the shares is deemed to have been acquired by the other enterprise; the latter enterprise is deemed to be the acquirer and applies the purchase method to the assets and liabilities of the enterprise issuing the shares.

Unitings of interests

13. In exceptional circumstances, it may not be possible to identify an acquirer. Instead of a dominant party emerging, the shareholders of the combining enterprises join in a substantially equal arrangement to share control over the whole, or effectively the whole, of their net assets and operations. In addition, the managements of the combining enterprises participate in the management of the combined entity. As a result, the shareholders of the combining enterprises share mutually in the risks and benefits of the combined entity. Such a business combination is accounted for as a uniting of interests.

14. A mutual sharing of risks and benefits is usually not possible without a substantially equal exchange of voting common shares between the combining enterprises. Such an exchange ensures that the relative ownership interests of the combining enterprises, and consequently their relative risks and benefits in the combined enterprise, are maintained and the decision-making powers of the parties are preserved. However, for a substantially equal share exchange to be effective in this regard there cannot be a significant reduction in the rights attaching to the shares of one of the combining enterprises, otherwise the influence of that party is weakened.

15. In order to achieve a mutual sharing of the risks and benefits of the combined entity:

(a) the substantial majority, if not all, of the voting common shares of the combining enterprises are exchanged or pooled;

(b) the fair value of one enterprise is not significantly different from that of the other enterprise; and

(c) the shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity, relative to each other, after the combination as before.

16. The mutual sharing of the risks and benefits of the combined entity diminishes and the likelihood that an acquirer can be identified increases when:

(a) the relative equality in fair values of the combining enterprises is reduced and the percentage of voting common shares exchanged decreases;

(b) financial arrangements provide a relative advantage to one group of shareholders over the other shareholders. Such arrangements may take effect either prior to or after the business combination; and

(c) one party's share of the equity in the combined entity depends on how the business which it previously controlled performs subsequent to the business combination.

ACQUISITIONS

Accounting for acquisitions

17. ***A business combination which is an acquisition should be accounted for by use of the purchase method of accounting as set out in the standards contained in paragraphs 19 to 76.***

18. The use of the purchase method results in an acquisition of an enterprise being accounted for similarly to the purchase of other assets. This is appropriate since an acquisition involves a transaction in which assets are transferred, liabilities are incurred or capital is issued in exchange for control of the net assets and operations of another enterprise. The purchase method uses cost as the basis for recording the acquisition and relies on the exchange transaction underlying the acquisition for determination of the cost.

Date of acquisition

19. ***As from the date of acquisition, an acquirer should:***

(a) ***incorporate into the income statement the results of operations of the acquiree; and***

(b) ***recognise in the balance sheet the identifiable assets and liabilities of the acquiree and any goodwill or negative goodwill arising on the acquisition.***

20. The date of acquisition is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer and the date when application of the purchase method commences. The results of operations of an acquired business are included in the financial statements of the acquirer as from the date of acquisition, which is the date on which control of the acquiree is effectively transferred to the acquirer. In substance, the date of acquisition is the date from when the acquirer has the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Control is not deemed to have been transferred to the acquirer until all conditions necessary to protect the interests of the parties involved have been satisfied. However, this does not necessitate a transaction being closed or finalised at law before control effectively passes to the acquirer. In assessing whether control has effectively been transferred, the substance of the acquisition needs to be considered.

Cost of acquisition

21. ***An acquisition should be accounted for at its cost, being the amount of cash or cash equivalents paid or the fair value, at the date of exchange, of the other purchase consideration given by the acquirer in exchange for control over the net assets of the other enterprise, plus any costs directly attributable to the acquisition*** (2)***.***

22. When an acquisition involves more than one exchange transaction the cost of the acquisition is the aggregate cost of the individual transactions. When an acquisition is achieved in stages, the distinction between the date of acquisition and the date of the exchange transaction is important. While accounting for the acquisition commences as from the date of acquisition, it uses cost and fair value information determined as at the date of each exchange transaction.

23. Monetary assets given and liabilities incurred are measured at their fair values at the date of the exchange transaction. When settlement of the purchase consideration is deferred, the cost of the acquisition is the present value of the consideration, taking into account any premium or discount likely to be incurred in settlement, and not the nominal value of the payable.

24. In determining the cost of the acquisition, marketable securities issued by the acquirer are measured at their fair value which is their market price as at the date of the exchange transaction, provided that undue fluctuations or the narrowness of the market do not make the market price an unreliable indicator. When the market price on one particular date is not a reliable indicator, price movements for a reasonable period before and after the announcement of the terms of the acquisition need to be considered. When the market is unreliable or no quotation exists, the fair value of the securities issued by the acquirer is estimated by reference to their proportional interest in the fair value of the acquirer's enterprise or by reference to the proportional interest in the fair value of the enterprise acquired, whichever is the more clearly evident. Purchase

(2) SIC-28: business combinations — 'date of exchange' and fair value of equity instruments.

consideration which is paid in cash to shareholders of the acquiree as an alternative to securities may also provide evidence of the total fair value given. All aspects of the acquisition, including significant factors influencing the negotiations, need to be considered, and independent valuations may be used as an aid in determining the fair value of securities issued.

25. In addition to the purchase consideration, the acquirer may incur direct costs relating to the acquisition. These include the costs of registering and issuing equity securities, and professional fees paid to accountants, legal advisers, valuers and other consultants to effect the acquisition. General administrative costs, including the costs of maintaining an acquisitions department, and other costs which cannot be directly attributed to the particular acquisition being accounted for, are not included in the cost of the acquisition but are recognised as an expense as incurred.

Recognition of identifiable assets and liabilities

26. ***The identifiable assets and liabilities acquired that are recognised under paragraph 19 should be those of the acquiree that existed at the date of acquisition together with any liabilities recognised under paragraph 31. They should be recognised separately as at the date of acquisition if, and only if:***

(a) ***it is probable that any associated future economic benefits will flow to, or resources embodying economic benefits will flow from, the acquirer; and***

(b) ***a reliable measure is available of their cost or fair value.***

27. Assets and liabilities that are recognised under paragraph 26 are described in this Standard as identifiable assets and liabilities. To the extent that assets and liabilities are purchased which do not satisfy these recognition criteria there is a resultant impact on the amount of goodwill or negative goodwill arising on the acquisition, because goodwill or negative goodwill is determined as the residual cost of acquisition after recognising the identifiable assets and liabilities.

28. The identifiable assets and liabilities over which the acquirer obtains control may include assets and liabilities which were not previously recognised in the financial statements of the acquiree. This may be because they did not qualify for recognition prior to the acquisition. This is the case, for example, when a tax benefit arising from tax losses of the acquiree qualifies for recognition as an identifiable asset as a result of the acquirer earning sufficient taxable income.

29. ***Subject to paragraph 31, liabilities should not be recognised at the date of acquisition if they result from the acquirer's intentions or actions. Liabilities should also not be recognised for future losses or other costs expected to be incurred as a result of the acquisition, whether they relate to the acquirer or the acquiree.***

30. The liabilities referred to in paragraph 29 are not liabilities of the acquiree at the date of acquisition. Therefore, they are not relevant in allocating the cost of acquisition. None the less, this Standard contains one specific exception to this general principle. This exception applies if the acquirer has developed plans that relate to the acquiree's business and an obligation comes into existence as a direct consequence of the acquisition. Because these plans are an integral part of the acquirer's plan for the acquisition, this Standard requires an enterprise to recognise a provision for the resulting costs (see paragraph 31). For the purpose of this Standard, identifiable assets and liabilities acquired include the provisions recognised under paragraph 31. Paragraph 31 lays down strict conditions designed to ensure that the plans were an integral part of the acquisition and that within a short time — the earlier of three months after the date of acquisition and the date when the financial statements are authorised for issue the acquirer has developed the plans in a way that requires the enterprise to recognise a restructuring provision under IAS 37, provisions, contingent liabilities and contingent assets. This Standard also requires an enterprise to reverse such provisions if the plan is not implemented in the manner expected or within the time originally expected (see paragraph 75) and to disclose information on such provisions (see paragraph 92).

31. ***At the date of acquisition, the acquirer should recognise a provision that was not a liability of the acquiree at that date if, and only if, the acquirer has:***

(a) ***at, or before, the date of acquisition, developed the main features of a plan that involves terminating or reducing the activities of the acquiree and that relates:***

(i) ***to compensating employees of the acquiree for termination of their employment;***

(ii) ***to closing facilities of the acquiree;***

(iii) ***to eliminating product lines of the acquiree; or***

(iv) ***to terminating contracts of the acquiree that have become onerous because the acquirer has communicated to the other party at, or before, the date of acquisition that the contract will be terminated;***

(b) ***by announcing the main features of the plan at, or before, the date of acquisition, raised a valid expectation in those affected by the plan that it will implement the plan; and***

(c) ***by the earlier of three months after the date of acquisition and the date when the annual financial statements are authorised for issue, developed those main features into a detailed formal plan identifying at least:***

(i) ***the business or part of a business concerned;***

(ii) ***the principal locations affected;***

(iii) ***the location, function, and approximate number of employees who will be compensated for terminating their services;***

(iv) ***the expenditures that will be undertaken; and***

(v) ***when the plan will be implemented.***

Any provision recognised under this paragraph should cover only the costs of the items listed in (a)(i) to (iv).

Allocation of cost of acquisition

Benchmark treatment

32. ***The identifiable assets and liabilities recognised under paragraph 26 should be measured at the aggregate of:***

(a) ***the fair value of the identifiable assets and liabilities acquired as at the date of the exchange transaction to the extent of the acquirer's interest obtained in the exchange transaction; and***

(b) ***the minority's proportion of the pre-acquisition carrying amounts of the identifiable assets and liabilities of the subsidiary.***

Any goodwill or negative goodwill should be accounted for under this Standard.

33. The cost of an acquisition is allocated to the identifiable assets and liabilities recognised under paragraph 26 by reference to their fair values at the date of the exchange transaction. However, the cost of the acquisition only relates to the percentage of the identifiable assets and liabilities purchased by the acquirer. Consequently, when an acquirer purchases less than all the shares of the other enterprise, the resulting minority interest is stated at the minority's proportion of the pre-acquisition carrying amounts of the net identifiable assets of the subsidiary. This is because the minority's proportion has not been part of the exchange transaction to effect the acquisition.

Allowed alternative treatment

34. ***The identifiable assets and liabilities recognised under paragraph 26 should be measured at their fair values as at the date of acquisition. Any goodwill or negative goodwill should be accounted for under this Standard. Any minority interest should be stated at the minority's proportion of the fair values of the identifiable assets and liabilities recognised under paragraph 26.***

35. Under this approach, the net identifiable assets over which the acquirer has obtained control are stated at their fair values, regardless of whether the acquirer has acquired all or only some of the capital of the other enterprise or has acquired the assets directly. Consequently, any minority interest is stated at the minority's proportion of the fair values of the net identifiable assets of the subsidiary.

Successive share purchases

36. An acquisition may involve more than one exchange transaction, as for example when it is achieved in stages by successive purchases on a stock exchange. When this occurs, each significant transaction is treated separately for the purpose of determining the fair values of the identifiable assets and liabilities acquired and for determining the amount of any goodwill or negative goodwill on that transaction. This results in a step-by-step comparison of the cost of the individual investments with the acquirer's percentage interest in the fair values of the identifiable assets and liabilities acquired at each significant step.

37. When an acquisition is achieved by successive purchases, the fair values of the identifiable assets and liabilities may vary at the date of each exchange transaction. If all the identifiable assets and liabilities relating to an acquisition are restated to fair values at the time of successive purchases, any adjustment relating to the previously held interest of the acquirer is a revaluation and is accounted for as such.

38. Prior to qualifying as an acquisition, a transaction may qualify as an investment in an associate and be accounted for by use of the equity method under IAS 28, accounting for investments in associates. If so, the determination of fair values for the identifiable assets and liabilities acquired and the recognition of goodwill or negative goodwill occurs notionally as from the date when the equity method is applied. When the investment did not qualify previously as an associate, the fair values of the identifiable assets and liabilities are determined as at the date of each significant step and goodwill or negative goodwill is recognised from the date of acquisition.

Determining the fair values of identifiable assets and liabilities acquired

39. General guidelines for arriving at the fair values of identifiable assets and liabilities acquired are as follows:

(a) marketable securities at their current market values;

(b) non-marketable securities at estimated values that take into consideration features such as price earnings ratios, dividend yields and expected growth rates of comparable securities of enterprises with similar characteristics;

(c) receivables at the present values of the amounts to be received, determined at appropriate current interest rates, less allowances for uncollectability and collection costs, if necessary. However, discounting is not required for short-term receivables when the difference between the nominal amount of the receivable and the discounted amount is not material;

(d) inventories:

(i) finished goods and merchandise at selling prices less the sum of (a) the costs of disposal and (b) a reasonable profit allowance for the selling effort of the acquirer based on profit for similar finished goods and merchandise;

(ii) work in progress at selling prices of finished goods less the sum of (a) costs to complete, (b) costs of disposal and (c) a reasonable profit allowance for the completing and selling effort based on profit for similar finished goods; and

(iii) raw materials at current replacement costs;

(e) land and buildings at their market value;

(f) plant and equipment at market value, normally determined by appraisal. When there is no evidence of market value because of the specialised nature of the plant and equipment or because the items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost;

(g) intangible assets, as defined in IAS 38, intangible assets, at fair value determined:

(i) by reference to an active market as defined in IAS 38; and

(ii) if no active market exists, on a basis that reflects the amount that the enterprise would have paid for the asset in an arm's length transaction between knowledgeable willing parties, based on the best information available (see IAS 38 for further guidance on determining the fair value of an intangible asset acquired in a business combination);

(h) net employee benefit assets or liabilities for defined benefit plans at the present value of the defined benefit obligation less the fair value of any plan assets. However, an asset is only recognised to the extent that it is probable that it will be available to the enterprise in the form of refunds from the plan or a reduction in future contributions;

(i) tax assets and liabilities at the amount of the tax benefit arising from tax losses or the taxes payable in respect of the net profit or loss, assessed from the perspective of the combined entity or group resulting from the acquisition. The tax asset or liability is determined after allowing for the tax effect of restating identifiable assets and liabilities to their fair values and is not discounted. The tax assets include any deferred tax asset of the acquirer that was not recognised prior to the business combination, but which, as a consequence of the business combination, now satisfies the recognition criteria in IAS 12, income taxes;

(j) accounts and notes payable, long-term debt, liabilities, accruals and other claims payable at the present values of amounts to be disbursed in meeting the liability determined at appropriate current interest rates. However, discounting is not required for short-term liabilities when the difference between the nominal amount of the liability and the discounted amount is not material;

(k) onerous contracts and other identifiable liabilities of the acquiree at the present values of amounts to be disbursed in meeting the obligation determined at appropriate current interest rates; and

(l) provisions for terminating or reducing activities of the acquiree that are recognised under paragraph 31, at an amount determined under IAS 37, provisions, contingent liabilities and contingent assets.

Certain of the guidelines above assume that fair values will be determined by the use of discounting. When the guidelines do not refer to the use of discounting, discounting may or may not be used in determining the fair values of identifiable assets and liabilities.

40. ***If the fair value of an intangible asset cannot be measured by reference to an active market (as defined in IAS 38, intangible assets), the amount recognised for that intangible asset at the date of the acquisition should be limited to an amount that does not create or increase negative goodwill that arises on the acquisition (see paragraph 59).***

Goodwill arising on acquisition

Recognition and measurement

41. ***Any excess of the cost of the acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired as at the date of the exchange transaction should be described as goodwill and recognised as an asset.***

42. Goodwill arising on acquisition represents a payment made by the acquirer in anticipation of future economic benefits. The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the acquisition.

43. ***Goodwill should be carried at cost less any accumulated amortisation and any accumulated impairment losses.***

Amortisation

44. ***Goodwill should be amortised on a systematic basis over its useful life. The amortisation period should reflect the best estimate of the period during which future economic benefits are expected to flow to the enterprise. There is a rebuttable presumption that the useful life of goodwill will not exceed 20 years from initial recognition.***

45. ***The amortisation method used should reflect the pattern in which the future economic benefits arising from goodwill are expected to be consumed. The straight-line method should be adopted unless there is persuasive evidence that another method is more appropriate in the circumstances.***

46. ***The amortisation for each period should be recognised as an expense.***

47. With the passage of time, goodwill diminishes, reflecting the fact that its service potential is decreasing. In some cases, the value of goodwill may appear not to decrease over time. This is because the potential for economic benefits that was purchased initially is being progressively replaced by the potential for economic benefits resulting from subsequent enhancements of goodwill. In other words, the goodwill that was purchased is being replaced by internally generated goodwill. IAS 38, intangible assets, prohibits the recognition of internally generated goodwill as an asset. Therefore, it is appropriate that goodwill is amortised on a systematic basis over the best estimate of its useful life.

48. Many factors need to be considered in estimating the useful life of goodwill including:

(a) the nature and foreseeable life of the acquired business;

(b) the stability and foreseeable life of the industry to which the goodwill relates;

(c) public information on the characteristics of goodwill in similar businesses or industries and typical lifecycles of similar businesses;

(d) the effects of product obsolescence, changes in demand and other economic factors on the acquired business;

(e) the service life expectancies of key individuals or groups of employees and whether the acquired business could be efficiently managed by another management team;

(f) the level of maintenance expenditure or of funding required to obtain the expected future economic benefits from the acquired business and the company's ability and intent to reach such a level;

(g) expected actions by competitors or potential competitors; and

(h) the period of control over the acquired business and legal, regulatory or contractual provisions affecting its useful life.

49. Because goodwill represents, among other things, future economic benefits from synergy or assets that cannot be recognised separately, it is difficult to estimate its useful life. Estimates of its useful life become less reliable as the length of the useful life increases. The presumption in this Standard is that goodwill does not normally have a useful life in excess of 20 years from initial recognition.

50. In rare cases, there may be persuasive evidence that the useful life of goodwill will be a specific period longer than 20 years. Although examples are difficult to find, this may occur when the goodwill is so clearly related to an identifiable asset or a group of identifiable assets that it can reasonably be expected to benefit the acquirer over the useful life of the identifiable asset or group of assets. In these cases, the presumption that the useful life of goodwill will not exceed 20 years is rebutted and the enterprise:

(a) amortises the goodwill over the best estimate of its useful life;

(b) estimates the recoverable amount of the goodwill at least annually to identify any impairment loss (see paragraph 56); and

(c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the goodwill (see paragraph 88(b)).

51. The useful life of goodwill is always finite. Uncertainty justifies estimating the useful life of goodwill on a prudent basis, but it does not justify estimating a useful life that is unrealistically short.

52. There will rarely, if ever, be persuasive evidence to support an amortisation method for goodwill other than the straight-line basis, especially if that other method results in a lower amount of accumulated amortisation than under the straight-line method. The amortisation method is applied consistently from period to period unless there is a change in the expected pattern of economic benefits from goodwill.

53. When accounting for an acquisition, there may be circumstances in which the goodwill on acquisition does not reflect future economic benefits that are expected to flow to the acquirer. For example, since negotiating the purchase consideration, there may have been a decline in the expected future cash flows from the net identifiable assets acquired. In this case, an enterprise tests the goodwill for impairment under IAS 36, impairment of assets, and accounts for any impairment loss accordingly.

54. ***The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of goodwill is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from goodwill, the method should be changed to reflect the changed pattern. Such changes should be accounted for as changes in accounting estimates under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, by adjusting the amortisation charge for the current and future periods.***

Recoverability of the carrying amount — impairment losses

55. To determine whether goodwill is impaired, an enterprise applies IAS 36, impairment of assets. IAS 36 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.

56. ***In addition to following the requirements included in IAS 36, impairment of assets, an enterprise should, at least at each financial year end, estimate in accordance with IAS 36 the recoverable amount of goodwill that is amortised over a period exceeding 20 years from initial recognition, even if there is no indication that it is impaired.***

57. It is sometimes difficult to identify whether goodwill is impaired, particularly if it has a long useful life. As a consequence, this Standard requires, as a minimum, an annual calculation of the recoverable amount of goodwill if its useful life exceeds 20 years from initial recognition.

58. The requirement for an annual impairment test of goodwill applies whenever the current total estimated useful life of the goodwill exceeds 20 years from its initial recognition. Therefore, if the useful life of goodwill was estimated to be less than 20 years at initial recognition, but the estimated useful life is subsequently extended to exceed 20 years from when the goodwill was initially recognised, an enterprise performs the impairment test required under paragraph 56 and gives the disclosure required under paragraph 88(b).

Negative goodwill arising on acquisition

Recognition and measurement

59. ***Any excess, as at the date of the exchange transaction, of the acquirer's interest in the fair values of the identifiable assets and liabilities acquired over the cost of the acquisition, should be recognised as negative goodwill.***

60. The existence of negative goodwill may indicate that identifiable assets have been overstated and identifiable liabilities have been omitted or understated. It is important to ensure that this is not the case before negative goodwill is recognised.

61. ***To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquirer's plan for the acquisition and can be measured reliably, but which do not represent identifiable liabilities at the date of acquisition (see paragraph 26), that portion of negative goodwill should be recognised as income in the income statement when the future losses and expenses are recognised. If these identifiable future losses and expenses are not recognised in the expected period, negative goodwill should be treated under paragraph 62 (a) and (b).***

62. ***To the extent that negative goodwill does not relate to identifiable expected future losses and expenses that can be measured reliably at the date of acquisition, negative goodwill should be recognised as income in the income statement as follows:***

(a) ***the amount of negative goodwill not exceeding the fair values of acquired identifiable non-monetary assets should be recognised as income on a systematic basis over the remaining weighted average useful life of the identifiable acquired depreciable/amortisable assets; and***

(b) ***the amount of negative goodwill in excess of the fair values of acquired identifiable non-monetary assets should be recognised as income immediately.***

63. To the extent that negative goodwill does not relate to expectations of future losses and expenses that have been identified in the acquirer's plan for the acquisition and can be measured reliably, negative goodwill is a gain which is recognised as income when the future economic benefits embodied in the identifiable depreciable/amortisable assets acquired are consumed. In the case of monetary assets, the gain is recognised as income immediately.

Presentation

64. ***Negative goodwill should be presented as a deduction from the assets of the reporting enterprise, in the same balance sheet classification as goodwill.***

Adjustments to purchase consideration contingent on future events

65. ***When the acquisition agreement provides for an adjustment to the purchase consideration contingent on one or more future events, the amount of the adjustment should be included in the cost of the acquisition as at the date of acquisition if the adjustment is probable and the amount can be measured reliably.***

66. Acquisition agreements may allow for adjustments to be made to the purchase consideration in the light of one or more future events. The adjustments may be contingent on a specified level of earnings being maintained or achieved in future periods or on the market price of the securities issued as part of the purchase consideration being maintained.

67. When initially accounting for an acquisition, it is usually possible to estimate the amount of any adjustment to the purchase consideration, even though some uncertainty exists, without impairing the reliability of the information. If the future events do not occur, or the estimate needs to be revised, the cost of the acquisition is adjusted with a consequential effect on goodwill, or negative goodwill, as the case may be.

Subsequent changes in cost of acquisition

68. ***The cost of the acquisition should be adjusted when a contingency affecting the amount of the purchase consideration is resolved subsequent to the date of the acquisition, so that payment of the amount is probable and a reliable estimate of the amount can be made.***

69. The terms of an acquisition may provide for an adjustment of the purchase consideration if the results from the acquiree's operations exceed or fall short of an agreed level after acquisition. When the adjustment subsequently becomes probable and a reliable estimate can be made of the amount, the acquirer treats the additional consideration as an adjustment to the cost of acquisition, with a consequential effect on goodwill, or negative goodwill, as the case may be.

70. In some circumstances, the acquirer may be required to make subsequent payment to the seller as compensation for a reduction in the value of the purchase consideration. This is the case when the acquirer has guaranteed the market price of securities or debt issued as consideration and has to make a further issue of securities or debt for the purpose of restoring the originally determined cost of acquisition. In such cases, there is no increase in the cost of acquisition and, consequently, no adjustment to goodwill or negative goodwill. Instead, the increase in securities or debt issued represents a reduction in the premium or an increase in the discount on the initial issue.

Subsequent identification or changes in value of identifiable assets and liabilities ([3])

71. ***Identifiable assets and liabilities, which are acquired but which do not satisfy the criteria in paragraph 26 for separate recognition when the acquisition is initially accounted for, should be recognised subsequently as and when they satisfy the criteria. The carrying amounts of identifiable assets and liabilities acquired should be adjusted when, subsequent to acquisition, additional evidence becomes available to assist with the estimation of the amounts assigned to those identifiable assets and liabilities when the acquisition was initially accounted for. The amount assigned to goodwill or negative goodwill should also be adjusted, when necessary, to the extent that:***

(a) ***the adjustment does not increase the carrying amount of goodwill above its recoverable amount, as defined in IAS 36, impairment of assets; and***

([3]) See also SIC-22: business combinations — subsequent adjustment of fair values and goodwill initially reported.

(b) ***such adjustment is made by the end of the first annual accounting period commencing after acquisition (except for the recognition of an identifiable liability under paragraph 31, for which the timeframe in paragraph 31(c) applies);***

otherwise the adjustments to the identifiable assets and liabilities should be recognised as income or expense.

72. Identifiable assets and liabilities of an acquiree may not have been recognised at the time of acquisition because they did not meet the recognition criteria for identifiable assets and liabilities or the acquirer was unaware of their existence. Similarly, the fair values assigned at the date of acquisition to the identifiable assets and liabilities acquired may need to be adjusted as additional evidence becomes available to assist with the estimation of the value of the identifiable asset or liability at the date of acquisition. When the identifiable assets or liabilities are recognised or the carrying amounts are adjusted after the end of the first annual accounting period (excluding interim periods) commencing after acquisition, income or expense is recognised rather than an adjustment to goodwill or negative goodwill. This timelimit, while arbitrary in its length, prevents goodwill and negative goodwill from being reassessed and adjusted indefinitely.

73. Under paragraph 71, the carrying amount of goodwill (negative goodwill) is adjusted if, for example, there is an impairment loss before the end of the first annual accounting period commencing after acquisition for an identifiable asset acquired and the impairment loss does not relate to specific events or changes in circumstances occurring after the date of acquisition.

74. When, subsequent to acquisition but prior to the end of the first annual accounting period commencing after acquisition, the acquirer becomes aware of the existence of a liability which had existed at the date of acquisition or of an impairment loss that does not relate to specific events or changes in circumstances occurring after the date of acquisition, goodwill is not increased above its recoverable amount determined under IAS 36.

75. ***If provisions for terminating or reducing activities of the acquiree were recognised under paragraph 31, these provisions should be reversed if, and only if:***

(a) ***the outflow of economic benefits is no longer probable; or***

(b) ***the detailed formal plan is not implemented:***

(i) ***in the manner set out in the detailed formal plan; or***

(ii) ***within the time established in the detailed formal plan.***

Such a reversal should be reflected as an adjustment to goodwill or negative goodwill (and minority interests, if appropriate), so that no income or expense is recognised in respect of it. The adjusted amount of goodwill should be amortised prospectively over its remaining useful life. The adjusted amount of negative goodwill should be dealt with under paragraph 62(a) and (b).

76. No subsequent adjustment is normally necessary in respect of provisions recognised under paragraph 31, as the detailed formal plan is required to identify the expenditures that will be undertaken. If the expenditures have not occurred in the expected period, or are no longer expected to occur, it is necessary to adjust the provision for terminating or reducing activities of the acquiree, with a corresponding adjustment to the amount of goodwill or negative goodwill (and minority interests, if appropriate). If subsequently, there is any obligation that is required to be recognised under IAS 37, provisions, contingent liabilities and contingent assets, the enterprise recognises a corresponding expense.

UNITINGS OF INTERESTS

Accounting for unitings of interests

77. ***A uniting of interests should be accounted for by use of the pooling of interests method as set out in paragraphs 78, 79 and 82.***

78. ***In applying the pooling of interests method, the financial statement items of the combining enterprises for the period in which the combination occurs and for any comparative periods disclosed should be included in the financial statements of the combined enterprises as if they had been combined from the beginning of the earliest period presented. The financial statements of an enterprise should not incorporate a uniting of interests to which the enterprise is a party if the date of the uniting of interests is after the date of the most recent balance sheet included in the financial statements.***

79. ***Any difference between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount recorded for the share capital acquired should be adjusted against equity.***

80. The substance of a uniting of interests is that no acquisition has occurred and there has been a continuation of the mutual sharing of risks and benefits that existed prior to the business combination. Use of the pooling of interests method recognises this by accounting for the combined enterprises as though the separate businesses were continuing as before, though now jointly owned and managed. Accordingly, only minimal changes are made in aggregating the individual financial statements.

81. Since a uniting of interests results in a single combined entity, a single uniform set of accounting policies is adopted by that entity. Therefore, the combined entity recognises the assets, liabilities and equity of the combining enterprises at their existing carrying amounts adjusted only as a result of conforming the combining enterprises' accounting policies and applying those policies to all periods presented. There is no recognition of any new goodwill or negative goodwill. Similarly, the effects of all transactions between the combining enterprises, whether occurring before or after the uniting of interests, are eliminated in preparing the financial statements of the combined entity.

82. ***Expenditures incurred in relation to a uniting of interests should be recognised as expenses in the period in which they are incurred.***

83. Expenditures incurred in relation to a uniting of interests include registration fees, costs of furnishing information to shareholders, finders and consultants fees, and salaries and other expenses related to services of employees involved in achieving the business combination. They also include any costs or losses incurred in combining operations of the previously separate businesses.

ALL BUSINESS COMBINATIONS

Taxes on income

84. In some countries, the accounting treatment for a business combination may differ from that applied under their respective income tax laws. Any resulting deferred tax liabilities and deferred tax assets are recognised under IAS 12, income taxes.

85. The potential benefit of income tax loss carryforwards, or other deferred tax assets, of an acquired enterprise, which were not recognised as an identifiable asset by the acquirer at the date of acquisition, may subsequently be realised. When this occurs, the acquirer recognises the benefit as income under IAS 12, income taxes. 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, this procedure does not create negative goodwill, nor does it increase the carrying amount of negative goodwill.

DISCLOSURE

86. ***For all business combinations, the following disclosures should be made in the financial statements for the period during which the combination has taken place:***

(a) ***the names and descriptions of the combining enterprises;***

(b) ***the method of accounting for the combination;***

(c) ***the effective date of the combination for accounting purposes; and***

(d) ***any operations resulting from the business combination which the enterprise has decided to dispose of.***

87. ***For a business combination which is an acquisition, the following additional disclosures should be made in the financial statements for the period during which the acquisition has taken place:***

(a) ***the percentage of voting shares acquired; and***

(b) ***the cost of acquisition and a description of the purchase consideration paid or contingently payable.***

88. ***For goodwill, the financial statements should disclose:***

(a) ***the amortisation period(s) adopted;***

(b) ***if goodwill is amortised over more than 20 years, the reasons why the presumption that the useful life of goodwill will not exceed 20 years from initial recognition is rebutted. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the goodwill;***

(c) ***if goodwill is not amortised on the straight-line basis, the basis used and reason why that basis is more appropriate than the straight-line basis;***

(d) ***the line item(s) of the income statement in which the amortisation of goodwill is included; and***

(e) ***a reconciliation of the carrying amount of goodwill at the beginning and end of the period showing:***

(i) ***the gross amount and the accumulated amortisation (aggregated with accumulated impairment losses), at the beginning of the period;***

(ii) ***any additional goodwill recognised during the period;***

(iii) ***any adjustments resulting from subsequent identification or changes in value of identifiable assets and liabilities;***

(iv) ***any goodwill derecognised on the disposal of all or part of the business to which it relates during the period;***

(v) ***amortisation recognised during the period;***

(vi) ***impairment losses recognised during the period under IAS 36, impairment of assets (if any);***

(vii) ***impairment losses reversed during the period under IAS 36 (if any);***

(viii) ***other changes in the carrying amount during the period (if any); and***

(ix) ***the gross amount and the accumulated amortisation (aggregated with accumulated impairment losses), at the end of the period.***

Comparative information is not required.

89. When an enterprise describes the factor(s) that played a significant role in determining the useful life of goodwill that is amortised over more than 20 years, the enterprise considers the list of factors in paragraph 48.

90. An enterprise discloses information on impaired goodwill under IAS 36 in addition to the information required by paragraph 88(e)(vi) and (vii).

91. ***For negative goodwill, the financial statements should disclose:***

(a) ***to the extent that negative goodwill is treated under paragraph 61, a description, the amount and the timing of the expected future losses and expenses;***

(b) ***the period(s) over which negative goodwill is recognised as income;***

(c) ***the line item(s) of the income statement in which negative goodwill is recognised as income; and***

(d) ***a reconciliation of the carrying amount of negative goodwill at the beginning and end of the period showing:***

(i) ***the gross amount of negative goodwill and the accumulated amount of negative goodwill already recognised as income, at the beginning of the period;***

(ii) ***any additional negative goodwill recognised during the period;***

(iii) ***any adjustments resulting from subsequent identification or changes in value of identifiable assets and liabilities;***

(iv) ***any negative goodwill derecognised on the disposal of all or part of the business to which it relates during the period;***

(v) ***negative goodwill recognised as income during the period, showing separately the portion of negative goodwill recognised as income under paragraph 61 (if any);***

(vi) ***other changes in the carrying amount during the period (if any); and***

(vii) ***the gross amount of negative goodwill and the accumulated amount of negative goodwill already recognised as income, at the end of the period.***

Comparative information is not required.

92. ***The disclosure requirements of IAS 37, provisions, contingent liabilities and contingent assets, apply to provisions recognised under paragraph 31 for terminating or reducing the activities of an acquiree. These provisions should be treated as a separate class of provisions for the purpose of disclosure under IAS 37. In addition, the aggregate carrying amount of these provisions should be disclosed for each individual business combination.***

93. ***In an acquisition, if the fair values of the identifiable assets and liabilities or the purchase consideration can only be determined on a provisional basis at the end of the period in which the acquisition took place, this should be stated and reasons given. When there are subsequent adjustments to such provisional fair values, those adjustments should be disclosed and explained in the financial statements of the period concerned.***

94. ***For a business combination which is a uniting of interests, the following additional disclosures should be made in the financial statements for the period during which the uniting of interests has taken place:***

(a) ***description and number of shares issued, together with the percentage of each enterprise's voting shares exchanged to effect the uniting of interests;***

(b) ***amounts of assets and liabilities contributed by each enterprise; and***

(c) ***sales revenue, other operating revenues, extraordinary items and the net profit or loss of each enterprise prior to the date of the combination that are included in the net profit or loss shown by the combined enterprise's financial statements.***

95. General disclosures required to be made in consolidated financial statements are contained in IAS 27, consolidated financial statements and accounting for investments in subsidiaries.

96. ***For business combinations effected after the balance sheet date, the information required by paragraphs 86 to 94 should be disclosed. If it is impracticable to disclose any of this information, this fact should be disclosed.***

97. Business combinations which have been effected after the balance sheet date and before the date on which the financial statements of one of the combining enterprises are authorised for issue are disclosed if they are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions (see IAS 10, events after the balance sheet date).

98. In certain circumstances, the effect of the combination may be to allow the financial statements of the combined enterprise to be prepared in accordance with the going concern assumption. This might not have been possible for one or both of the combining enterprises. This may occur, for example, when an enterprise with cash flow difficulties combines with an enterprise having access to cash that can be used in the enterprise with a need for cash. If this is the case, disclosure of this information in the financial statements of the enterprise having the cash flow difficulties is relevant.

TRANSITIONAL PROVISIONS

99. ***At the date when this Standard becomes effective (or at the date of adoption, if earlier), it should be applied as set out in the following tables. In all cases other than those detailed in the following tables, this Standard should be applied retrospectively, unless it is impracticable to do so.***

100. ***The effect of adopting this Standard on its effective date (or earlier) should be recognised under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, that is, as an adjustment either to the opening balance of retained earnings of the earliest period presented (IAS 8 benchmark treatment) or to the net profit or loss for the current period (IAS 8 allowed alternative treatment).***

101. ***In the first annual financial statements issued under this Standard, an enterprise should disclose the transitional provisions adopted where transitional provisions under this Standard permit a choice.***

Transitional provisions — Restatement of goodwill and negative goodwill

Circumstances	Requirements
1. Business combination that was an acquisition and arose in annual financial statements covering periods beginning before 1 January 1995.	
(a) Goodwill (negative goodwill) was written off against reserves.	Restatement of the goodwill (negative goodwill) is encouraged, but not required. If the goodwill (negative goodwill) is restated: (i) restate goodwill and negative goodwill for all acquisitions before 1 January 1995; (ii) determine the amount assigned to the goodwill (negative goodwill) at the date of acquisition under paragraph 41 (59) of this Standard and recognise the goodwill (negative goodwill) accordingly; and (iii) determine the accumulated amortisation of the goodwill (the accumulated amount of negative goodwill recognised as income) since the date of acquisition under paragraphs 44 to 54 (61 to 63) of this Standard and recognise it accordingly.

(b) Goodwill (negative goodwill) was recognised initially as an asset (deferred income) but not at the amount that would have been assigned under paragraph 41 (59) of this Standard.	Restatement of the goodwill (negative goodwill) is encouraged, but not required. If the goodwill (negative goodwill) is restated, apply the requirements under circumstances 1(a). If the goodwill (negative goodwill) is not restated, the amount assigned to the goodwill (negative goodwill) at the date of acquisition is deemed to have been properly determined. For the amortisation of goodwill (recognition of negative goodwill as income), see circumstances 3 or 4.

2. Business combination that was an acquisition and arose in annual financial statements covering periods beginning on or after 1 January 1995, but before this Standard is effective (or before the date of adoption of this Standard, if earlier).

(a) At the date of acquisition, the cost of the acquisition exceeded the acquirer's interest in the fair value of the identifiable assets and liabilities.	If the goodwill was recognised as an asset and the amount assigned to it at the date of acquisition was determined under paragraph 41 of this Standard, see transitional provisions for amortisation under circumstances 3 or 4. Otherwise: (i) determine the amount that would have been assigned to the goodwill at the date of acquisition under paragraph 41 of this Standard and recognise the goodwill accordingly; (ii) determine the related accumulated amortisation of the goodwill that would have been recognised under IAS 22 (revised 1993) and recognise it accordingly (the 20 year limit in IAS 22 (revised 1993) applies); and (iii) amortise any remaining carrying amount of the goodwill over its remaining useful life determined under this Standard (treatment as in circumstances 4).
(b) At the date of acquisition: (i) the cost of the acquisition was less than the acquirer's interest in the fair value of the identifiable assets and liabilities; and (ii) the fair values of the identifiable non-monetary assets acquired were reduced until the excess was eliminated (benchmark treatment under IAS 22 (revised 1993)).	Restatement of the negative goodwill is encouraged, but not required. If the negative goodwill is restated: (i) restate negative goodwill for all acquisitions after 1 January 1995; (ii) determine the amount that would have been assigned to the negative goodwill at the date of acquisition under paragraph 59 of this Standard and recognise the negative goodwill accordingly; (iii) determine the related accumulated amount of negative goodwill that would have been recognised as income under IAS 22 (revised 1993) and recognise it accordingly; and (iv) recognise any remaining carrying amount of the negative goodwill as income over the remaining weighted average useful life of the identifiable depreciable/amortisable non-monetary assets acquired (treatment as in circumstances 4).

	If the negative goodwill is not restated, the amount assigned to the negative goodwill (if any) at the date of acquisition is deemed to have been properly determined. For the recognition of negative goodwill as income, see circumstances 3 or 4.
(c) At the date of acquisition: (i) the cost of the acquisition was less than the acquirer's interest in the fair value of the identifiable assets and liabilities; and (ii) the fair values of the identifiable non-monetary assets acquired were not reduced to eliminate the excess (allowed alternative treatment under IAS 22 (revised 1993)).	If the negative goodwill was recognised and the amount assigned to it at the date of acquisition was determined under paragraph 59 of this Standard, see transitional provisions for the recognition of negative goodwill as income under circumstances 3 and 4. Otherwise: (i) determine the amount that would have been assigned to the negative goodwill at the date of acquisition under paragraph 59 of this Standard and recognise the negative goodwill accordingly; (ii) determine the related accumulated amount of the negative goodwill that would have been recognised as income under IAS 22 (revised 1993) and recognise it accordingly; and (iii) recognise any remaining carrying amount of the negative goodwill as income over the remaining weighted average useful life of the identifiable depreciable/amortisable non-monetary assets acquired (treatment as in circumstances 4).
3. Goodwill was recognised as an asset but was not previously amortised or the amortisation charge was deemed to be nil. Negative goodwill was recognised initially as a separate item in the balance sheet but was not subsequently recognised as income or the amount of negative goodwill to be recognised as income was deemed to be nil.	Restate the carrying amount of the goodwill (negative goodwill) as if the amortisation of goodwill (amount of negative goodwill recognised as income) had always been determined under this Standard (see paragraphs 44 to 54 (61 to 63)).
4. Goodwill (negative goodwill) was previously amortised (recognised as income).	Do not restate the carrying amount of the goodwill (negative goodwill) for any difference between accumulated amortisation (accumulated negative goodwill recognised as income) in prior years and that calculated under this Standard and: (i) amortise any carrying amount of the goodwill over its remaining useful life determined under this Standard (see paragraphs 44 to 54); and (ii) recognise any carrying amount of the negative goodwill as income over the remaining weighted average useful life of the identifiable depreciable/amortisable non-monetary assets acquired (see paragraph 62(a)). (i.e. any change is treated in the same way as a change in accounting estimate under IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies).

EFFECTIVE DATE

102. ***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 36, impairment of assets, IAS 37, provisions, contingent liabilities and contingent assets, and IAS 38, intangible assets, at the same time.***

103. This Standard supersedes IAS 22, business combinations, approved in 1993.

INTERNATIONAL ACCOUNTING STANDARD IAS 23 (REVISED 1993)

Borrowing costs

This revised International Accounting Standard supersedes IAS 23, capitalisation of borrowing costs, approved by the Board in March 1984. The revised Standard became effective for financial statements covering periods beginning on or after 1 January 1995.

One SIC interpretation relates to IAS 23:

— SIC-2: consistency — capitalisation of borrowing costs.

CONTENTS

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 borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

SCOPE

1. ***This Standard should be applied in accounting for borrowing costs.***

2. This Standard supersedes IAS 23, capitalisation of borrowing costs, approved in 1983.

3. This Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

DEFINITIONS

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

   Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

   A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

5. Borrowing costs may include:

   (a) interest on bank overdrafts and short-term and long-term borrowings;

   (b) amortisation of discounts or premiums relating to borrowings;

   (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

   (d) finance charges in respect of finance leases recognised in accordance with IAS 17, leases; and

   (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

6. Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and investment properties. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

BORROWING COSTS — BENCHMARK TREATMENT

Recognition

7. ***Borrowing costs should be recognised as an expense in the period in which they are incurred.***

8. Under the benchmark treatment borrowing costs are recognised as an expense in the period in which they are incurred regardless of how the borrowings are applied.

Disclosure

9. ***The financial statements should disclose the accounting policy adopted for borrowing costs.***

BORROWING COSTS — ALLOWED ALTERNATIVE TREATMENT

Recognition

10. ***Borrowing costs should be recognised as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 11.***

11. ***Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard*** (1)***.***

12. Under the allowed alternative treatment, borrowing costs that are directly attributable to the acquisition, construction or production of an asset are included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowing costs eligible for capitalisation

13. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.

14. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an enterprise is coordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other enterprises in the group. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the group operates in highly inflationary economies, and from fluctuations in exchange rates. As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.

15. ***To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.***

(1) See also SIC-2: consistency — capitalisation of borrowing costs.

16. The financing arrangements for a qualifying asset may result in an enterprise obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

17. ***To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.***

18. In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.

Excess of the carrying amount of the qualifying asset over recoverable amount

19. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other International Accounting Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other International Accounting Standards.

Commencement of capitalisation

20. ***The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when:***

    (a) ***expenditures for the asset are being incurred;***

    (b) ***borrowing costs are being incurred; and***

    (c) ***activities that are necessary to prepare the asset for its intended use or sale are in progress.***

21. Expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see IAS 20, accounting for government grants and disclosure of government assistance). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.

22. The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Suspension of capitalisation

23. ***Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.***

24. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of capitalisation

25. ***Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.***

26. An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

27. ***When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.***

28. A business park comprising several buildings, each of which can be used individually is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts. An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

DISCLOSURE

29. ***The financial statements should disclose:***

    (a) ***the accounting policy adopted for borrowing costs;***

    (b) ***the amount of borrowing costs capitalised during the period; and***

    (c) ***the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.***

TRANSITIONAL PROVISIONS

30. ***When the adoption of this Standard constitutes a change in accounting policy, an enterprise is encouraged to adjust its financial statements in accordance with IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies. Alternatively, enterprises following the allowed alternative treatment should capitalise only those borrowing costs incurred after the effective date of the Standard which meet the criteria for capitalisation.***

EFFECTIVE DATE

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

INTERNATIONAL ACCOUNTING STANDARD IAS 24 (REFORMATTED 1994)

Related party disclosures

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in March 1984. 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.

CONTENTS

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 dealing with related parties and transactions between a reporting enterprise and its related parties. The requirements of this Standard apply to the financial statements of each reporting enterprise.***

2. ***This Standard applies only to those related party relationships described in paragraph 3, as modified by paragraph 6.***

3. This Standard deals only with those related party relationships described in (a) to (e) below:

   (a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise. (This includes holding companies, subsidiaries and fellow subsidiaries);

   (b) associates (see IAS 28, accounting for investments in associates);

   (c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them significant influence over the enterprise, and close members of the family [1], of any such individual;

   (d) key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the reporting enterprise, including directors and officers of companies and close members of the families of such individuals; and

(1) Close members of the family of an individual are those that may be expected to influence, or be influenced by, that person in their dealings with the enterprise.

(e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

4. ***No disclosure of transactions is required:***

(a) ***in consolidated financial statements in respect of intra-group transactions;***

(b) ***in parent financial statements when they are made available or published with the consolidated financial statements;***

(c) ***in financial statements of a wholly-owned subsidiary if its parent is incorporated in the same country and provides consolidated financial statements in that country; and***

(d) ***in financial statements of State-controlled enterprises of transactions with other State-controlled enterprises.***

DEFINITIONS

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

Related party — parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

Related party transaction — a transfer of resources or obligations between related parties, regardless of whether a price is charged.

Control — ownership, directly, or indirectly through subsidiaries, of more than one half of the voting power of an enterprise, or a substantial interest in voting power and the power to direct, by statute or agreement, the financial and operating policies of the management of the enterprise.

Significant influence (for the purpose of this Standard) — participation in the financial and operating policy decisions of an enterprise, but not control of those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors but also by, for example, participation in the policy making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. With share ownership, significant influence is presumed in accordance with the definition contained in IAS 28, accounting for investments in associates.

6. In the context of this Standard, the following are deemed not to be related parties:

(a) two companies simply because they have a director in common, notwithstanding paragraphs 3(d) and (e), (but it is necessary to consider the possibility, and to assess the likelihood, that the director would be able to affect the policies of both companies in their mutual dealings);

(b) (i) providers of finance;

(ii) trade unions;

(iii) public utilities;

(iv) government departments and agencies,

in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of an enterprise or participate in its decision-making process); and

(c) a single customer, supplier, franchisor, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence.

THE RELATED PARTY ISSUE

7. Related party relationships are a normal feature of commerce and business. For example, enterprises frequently carry on separate parts of their activities through subsidiary or associated enterprises and acquire interests in other enterprises — for investment purposes or for trading reasons — that are of sufficient proportions that the investing company can control or exercise significant influence on the financial and operating decisions of its investee.

8. A related party relationship could have an effect on the financial position and operating results of the reporting enterprise. Related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same amounts as between unrelated parties.

9. The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the reporting enterprise with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same trade as the former partner. Alternatively, one party may refrain from acting because of the significant influence of another — for example, a subsidiary may be instructed by its parent not to engage in research and development.

10. Because there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required by this Standard.

11. Accounting recognition of a transfer of resources is normally based on the price agreed between the parties. Between unrelated parties the price is an arm's length price. Related parties may have a degree of flexibility in the price-setting process that is not present in transactions between unrelated parties.

12. A variety of methods is used to price transactions between related parties.

13. One way of determining a price for a transaction between related parties is by the comparable uncontrolled price method, which sets the price by reference to comparable goods sold in an economically comparable market to a buyer unrelated to the seller. Where the goods or services supplied in a related party transaction, and the conditions relating thereto, are similar to those in normal trading transactions, this method is often used. It is also often used for determining the cost of finance.

14. Where goods are transferred between related parties before sale to an independent party, the resale price method is often used. This reduces the resale price by a margin, representing an amount from which the re-seller would seek to cover his costs and make an appropriate profit, to arrive at a transfer price to the re-seller. There are problems of judgement in determining a compensation appropriate to the re-seller's contribution to the process. This method is also used for transfers of other resources, such as rights and services.

15. Another approach is the cost-plus method, which seeks to add an appropriate mark-up to the supplier's cost. Difficulties may be experienced in determining both the elements of cost attributable and the mark-up. Among the yardsticks that may assist in determining transfer prices are comparable returns in similar industries on turnover or capital employed.

16. Sometimes prices of related party transactions are not determined under one of the methods described in paragraphs 13 to 15. Sometimes, no price is charged — as in the examples of the free provision of management services and the extension of free credit on a debt.

17. Sometimes, transactions would not have taken place if the relationship had not existed. For example, a company that sold a large proportion of its production to its parent company at cost might not have found an alternative customer if the parent company had not purchased the goods.

DISCLOSURE

18. In many countries the laws require financial statements to give disclosures about certain categories of related parties. In particular, attention is focused on transactions with the directors of an enterprise, especially their remuneration and borrowings, because of the fiduciary nature of their relationship with the enterprise, as well as disclosures of significant intercompany transactions and investments in and balances with group and associated companies and with directors. IAS 27, consolidated financial statements and accounting for investments in subsidiaries, and IAS 28, accounting for investments in associates require disclosure of a list of significant subsidiaries and associates. IAS 8, net profit or loss for the period, fundamental errors and changes in accounting policies, requires disclosure of extraordinary items and items of income and expense within profit or loss from ordinary activities that are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period.

19. The following are examples of situations where related party transactions may lead to disclosures by a reporting enterprise in the period which they affect:

— purchases or sales of goods (finished or unfinished),

— purchases or sales of property and other assets,

— rendering or receiving of services,

— agency arrangements,

— leasing arrangements,

— transfer of research and development,

— licence agreements,

— finance (including loans and equity contributions in cash or in kind),

— guarantees and collaterals, and

— management contracts.

20. ***Related party relationships where control exists should be disclosed irrespective of whether there have been transactions between the related parties.***

21. In order for a reader of financial statements to form a view about the effects of related party relationships on a reporting enterprise, it is appropriate to disclose the related party relationship where control exists, irrespective of whether there have been transactions between the related parties.

22. ***If there have been transactions between related parties, the reporting enterprise should disclose the nature of the related party relationships as well as the types of transactions and the elements of the transactions necessary for an understanding of the financial statements.***

23. The elements of transactions necessary for an understanding of the financial statements would normally include:

    (a) an indication of the volume of the transactions, either as an amount or as an appropriate proportion;

    (b) amounts or appropriate proportions of outstanding items; and

    (c) pricing policies.

24. ***Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.***

25. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the parent and subsidiaries as a single reporting enterprise. Transactions with associated enterprises accounted for under the equity method are not eliminated and therefore require separate disclosure as related party transactions.

EFFECTIVE DATE

26. ***This International Accounting Standard becomes operative for financial statements covering the periods beginning on or after 1 January 1986.***

INTERNATIONAL ACCOUNTING STANDARD IAS 26 (REFORMATTED 1994)

Accounting and reporting by retirement benefit plans

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in June 1986. 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.

CONTENTS

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 the reports of retirement benefit plans where such reports are prepared.***

2. Retirement benefit plans are sometimes referred to by various other names, such as 'pension schemes', 'superannuation schemes' or 'retirement benefit schemes'. This Standard regards a retirement benefit plan as a reporting entity separate from the employers of the participants in the plan. All other International Accounting Standards apply to the reports of retirement benefit plans to the extent that they are not superseded by this Standard.

3. This Standard deals with accounting and reporting by the plan to all participants as a group. It does not deal with reports to individual participants about their retirement benefit rights.

4. IAS 19, employee benefits, is concerned with the determination of the cost of retirement benefits in the financial statements of employers having plans. Hence this Standard complements IAS 19.

5. Retirement benefit plans may be defined contribution plans or defined benefit plans. Many require the creation of separate funds, which may or may not have separate legal identity and may or may not have trustees, to which contributions are made and from which retirement benefits are paid. This Standard applies regardless of whether such a fund is created and regardless of whether there are trustees.

6. Retirement benefit plans with assets invested with insurance companies are subject to the same accounting and funding requirements as privately invested arrangements. Accordingly, they are within the scope of this Standard unless the contract with the insurance company is in the name of a specified participant or a group of participants and the retirement benefit obligation is solely the responsibility of the insurance company.

7. This Standard does not deal with other forms of employment benefits such as employment termination indemnities, deferred compensation arrangements, long-service leave benefits, special early retirement or redundancy plans, health and welfare plans or bonus plans. Government social security type arrangements are also excluded from the scope of this Standard.

DEFINITIONS

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

Retirement benefit plans are arrangements whereby an enterprise provides benefits for its employees on or after termination of service (either in the form of an annual income or as a lump sum) when such benefits, or the employer's contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the enterprise's practices.

Defined contribution plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon.

Defined benefit plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' earnings and/or years of service.

Funding is the transfer of assets to an entity (the fund) separate from the employer's enterprise to meet future obligations for the payment of retirement benefits.

For the purposes of this Standard the following terms are also used:

Participants are the members of a retirement benefit plan and others who are entitled to benefits under the plan.

Net assets available for benefits are the assets of a plan less liabilities other than the actuarial present value of promised retirement benefits.

Actuarial present value of promised retirement benefits is the present value of the expected payments by a retirement benefit plan to existing and past employees, attributable to the service already rendered.

Vested benefits are benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

9. Some retirement benefit plans have sponsors other than employers; this Standard also applies to the reports of such plans.

10. Most retirement benefit plans are based on formal agreements. Some plans are informal but have acquired a degree of obligation as a result of employers' established practices. While some plans permit employers to limit their obligations under the plans, it is usually difficult for an employer to cancel a plan if employees are to be retained. The same basis of accounting and reporting applies to an informal plan as to a formal plan.

11. Many retirement benefit plans provide for the establishment of separate funds into which contributions are made and out of which benefits are paid. Such funds may be administered by parties who act independently in managing fund assets. Those parties are called trustees in some countries. The term trustee is used in this Standard to describe such parties regardless of whether a trust has been formed.

12. Retirement benefit plans are normally described as either defined contribution plans or defined benefit plans, each having their own distinctive characteristics. Occasionally plans exist that contain characteristics of both. Such hybrid plans are considered to be defined benefit plans for the purposes of this Standard.

DEFINED CONTRIBUTION PLANS

13. ***The report of a defined contribution plan should contain a statement of net assets available for benefits and a description of the funding policy.***

14. Under a defined contribution plan, the amount of a participant's future benefits is determined by the contributions paid by the employer, the participant, or both, and the operating efficiency and investment earnings of the fund. An employer's obligation is usually discharged by contributions to the fund. An actuary's advice is not normally required although such advice is sometimes used to estimate future benefits that may be achievable based on present contributions and varying levels of future contributions and investment earnings.

15. The participants are interested in the activities of the plan because they directly affect the level of their future benefits. Participants are interested in knowing whether contributions have been received and proper control has been exercised to protect the rights of beneficiaries. An employer is interested in the efficient and fair operation of the plan.

16. The objective of reporting by a defined contribution plan is periodically to provide information about the plan and the performance of its investments. That objective is usually achieved by providing a report including the following:

(a) a description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;

(b) statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period; and

(c) a description of the investment policies.

DEFINED BENEFIT PLANS

17. ***The report of a defined benefit plan should contain either:***

(a) ***a statement that shows:***

(i) ***the net assets available for benefits;***

(ii) ***the actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits; and***

(iii) ***the resulting excess or deficit; or***

(b) ***a statement of net assets available for benefits including either:***

(i) ***a note disclosing the actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits; or***

(ii) ***a reference to this information in an accompanying actuarial report.***

If an actuarial valuation has not been prepared at the date of the report, the most recent valuation should be used as a base and the date of the valuation disclosed.

18. ***For the purposes of paragraph 17, the actuarial present value of promised retirement benefits should be based on the benefits promised under the terms of the plan on service rendered to date using either current salary levels or projected salary levels with disclosure of the basis used. The effect of any changes in actuarial assumptions that have had a significant effect on the actuarial present value of promised retirement benefits should also be disclosed.***

19. ***The report should explain the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits.***

20. Under a defined benefit plan, the payment of promised retirement benefits depends on the financial position of the plan and the ability of contributors to make future contributions to the plan as well as the investment performance and operating efficiency of the plan.

21. A defined benefit plan needs the periodic advice of an actuary to assess the financial condition of the plan, review the assumptions and recommend future contribution levels.

22. The objective of reporting by a defined benefit plan is periodically to provide information about the financial resources and activities of the plan that is useful in assessing the relationships between the accumulation of resources and plan benefits over time. This objective is usually achieved by providing a report including the following:

    (a) a description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;

    (b) statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period;

    (c) actuarial information either as part of the statements or by way of a separate report; and

    (d) a description of the investment policies.

Actuarial present value of promised retirement benefits

23. The present value of the expected payments by a retirement benefit plan may be calculated and reported using current salary levels or projected salary levels up to the time of retirement of participants.

24. The reasons given for adopting a current salary approach include:

    (a) the actuarial present value of promised retirement benefits, being the sum of the amounts presently attributable to each participant in the plan, can be calculated more objectively than with projected salary levels because it involves fewer assumptions;

    (b) increases in benefits attributable to a salary increase become an obligation of the plan at the time of the salary increase; and

    (c) the amount of the actuarial present value of promised retirement benefits using current salary levels is generally more closely related to the amount payable in the event of termination or discontinuance of the plan.

25. Reasons given for adopting a projected salary approach include:

    (a) financial information should be prepared on a going concern basis, irrespective of the assumptions and estimates that must be made;

    (b) under final pay plans, benefits are determined by reference to salaries at or near retirement date; hence salaries, contribution levels and rates of return must be projected; and

    (c) failure to incorporate salary projections, when most funding is based on salary projections, may result in the reporting of an apparent overfunding when the plan is not overfunded, or in reporting adequate funding when the plan is underfunded.

26. The actuarial present value of promised retirement benefits based on current salaries is disclosed in the report of a plan to indicate the obligation for benefits earned to the date of the report. The actuarial present value of promised retirement benefits based on projected salaries is disclosed to indicate the magnitude of the potential obligation on a going concern basis which is generally the basis for funding. In addition to disclosure of the actuarial present value of promised retirement benefits, sufficient explanation may need to be given so as to indicate clearly the context in which the actuarial present value of promised retirement benefits should be read. Such explanation may be in the form of information about the adequacy of the planned future funding and of the funding policy based on salary projections. This may be included in the financial information or in the actuary's report.

Frequency of actuarial valuations

27. In many countries, actuarial valuations are not obtained more frequently than every three years. If an actuarial valuation has not been prepared at the date of the report, the most recent valuation is used as a base and the date of the valuation disclosed.

Report content

28. For defined benefit plans, information is presented in one of the following formats which reflect different practices in the disclosure and presentation of actuarial information:

(a) a statement is included in the report that shows the net assets available for benefits, the actuarial present value of promised retirement benefits, and the resulting excess or deficit. The report of the plan also contains statements of changes in net assets available for benefits and changes in the actuarial present value of promised retirement benefits. The report may include a separate actuary's report supporting the actuarial present value of promised retirement benefits;

(b) a report that includes a statement of net assets available for benefits and a statement of changes in net assets available for benefits. The actuarial present value of promised retirement benefits is disclosed in a note to the statements. The report may also include a report from an actuary supporting the actuarial present value of promised retirement benefits; and

(c) a report that includes a statement of net assets available for benefits and a statement of changes in net assets available for benefits with the actuarial present value of promised retirement benefits contained in a separate actuarial report.

In each format a trustees' report in the nature of a management or directors' report and an investment report may also accompany the statements.

29. Those in favour of the formats described in paragraphs 28(a) and 28(b) believe that the quantification of promised retirement benefits and other information provided under those approaches help users to assess the current status of the plan and the likelihood of the plan's obligations being met. They also believe that financial reports should be complete in themselves and not rely on accompanying statements. However, some believe that the format described in paragraph 28(a) could give the impression that a liability exists, whereas the actuarial present value of promised retirement benefits does not in their opinion have all the characteristics of a liability.

30. Those who favour the format described in paragraph 28(c) believe that the actuarial present value of promised retirement benefits should not be included in a statement of net assets available for benefits as in the format described in paragraph 28(a) or even be disclosed in a note as in 28(b), because it will be compared directly with plan assets and such a comparison may not be valid. They contend that actuaries do not necessarily compare actuarial present value of promised retirement benefits with market values of investments but may instead assess the present value of cash flows expected from the investments. Therefore, those in favour of

this format believe that such a comparison is unlikely to reflect the actuary's overall assessment of the plan and that it may be misunderstood. Also, some believe that, regardless of whether quantified, the information about promised retirement benefits should be contained solely in the separate actuarial report where a proper explanation can be provided.

31. This Standard accepts the views in favour of permitting disclosure of the information concerning promised retirement benefits in a separate actuarial report. It rejects arguments against the quantification of the actuarial present value of promised retirement benefits. Accordingly, the formats described in paragraphs 28(a) and 28(b) are considered acceptable under this Standard, as is the format described in paragraph 28(c) so long as the financial information contains a reference to, and is accompanied by, an actuarial report that includes the actuarial present value of promised retirement benefits.

ALL PLANS

Valuation of plan assets

32. ***Retirement benefit plan investments should be carried at fair value. In the case of marketable securities fair value is market value. Where plan investments are held for which an estimate of fair value is not possible disclosure should be made of the reason why fair value is not used.***

33. In the case of marketable securities fair value is usually market value because this is considered the most useful measure of the securities at the report date and of the investment performance for the period. Those securities that have a fixed redemption value and that have been acquired to match the obligations of the plan, or specific parts thereof, may be carried at amounts based on their ultimate redemption value assuming a constant rate of return to maturity. Where plan investments are held for which an estimate of fair value is not possible, such as total ownership of an enterprise, disclosure is made of the reason why fair value is not used. To the extent that investments are carried at amounts other than market value or fair value, fair value is generally also disclosed. Assets used in the operations of the fund are accounted for in accordance with the applicable International Accounting Standards.

Disclosure

34. ***The report of a retirement benefit plan, whether defined benefit or defined contribution, should also contain the following information:***

    (a) ***a statement of changes in net assets available for benefits;***

    (b) ***a summary of significant accounting policies; and***

    (c) ***a description of the plan and the effect of any changes in the plan during the period.***

35. Reports provided by retirement benefit plans include the following, if applicable:

    (a) a statement of net assets available for benefits disclosing:

        (i) assets at the end of the period suitably classified;

        (ii) the basis of valuation of assets;

        (iii) details of any single investment exceeding either 5 % of the net assets available for benefits or 5 % of any class or type of security;

        (iv) details of any investment in the employer; and

        (v) liabilities other than the actuarial present value of promised retirement benefits;

(b) a statement of changes in net assets available for benefits showing the following:

(i) employer contributions;

(ii) employee contributions;

(iii) investment income such as interest and dividends;

(iv) other income;

(v) benefits paid or payable (analysed, for example, as retirement, death and disability benefits, and lump sum payments);

(vi) administrative expenses;

(vii) other expenses;

(viii) taxes on income;

(ix) profits and losses on disposal of investments and changes in value of investments; and

(x) transfers from and to other plans;

(c) a description of the funding policy;

(d) for defined benefit plans, the actuarial present value of promised retirement benefits (which may distinguish between vested benefits and non-vested benefits) based on the benefits promised under the terms of the plan, on service rendered to date and using either current salary levels or projected salary levels; this information may be included in an accompanying actuarial report to be read in conjunction with the related financial information; and

(e) for defined benefit plans, a description of the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits.

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

(a) the names of the employers and the employee groups covered;

(b) the number of participants receiving benefits and the number of other participants, classified as appropriate;

(c) the type of plan — defined contribution or defined benefit;

(d) a note as to whether participants contribute to the plan;

(e) a description of the retirement benefits promised to participants;

(f) a description of any plan termination terms; and

(g) changes in items (a) to (f) during the period covered by the report.

It is not uncommon to refer to other documents that are readily available to users and in which the plan is described, and to include only information on subsequent changes in the report.

EFFECTIVE DATE

37. ***This International Accounting Standard becomes operative for financial statements of retirement benefit plans covering periods beginning on or after 1 January 1988.***

INTERNATIONAL ACCOUNTING STANDARD IAS 27 (REVISED 2000)

Consolidated financial statements and accounting for investments in subsidiaries

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in June 1988. 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 December 1998, paragraphs 13, 24, 29 and 30 were amended to replace references to IAS 25, accounting for investments, by references to IAS 39, financial instruments: recognition and measurement.

In October 2000, paragraph 13 was amended to make the wording consistent with similar paragraphs in other related International Accounting Standards.

The following SIC interpretations relate to IAS 27:

— SIC-12: consolidation — special purpose entities,

— SIC-33: consolidation and equity method — potential voting rights and allocation of ownership interests

CONTENTS

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 the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.***

2. ***This Standard should also be applied in accounting for investments in subsidiaries in a parent's separate financial statements.***

3. This Standard supersedes IAS 3, consolidated financial statements, except insofar as that Standard deals with accounting for investments in associates (see IAS 28, accounting for investment in associates).

4. Consolidated financial statements are encompassed by the term 'financial statements' included in the 'Preface to International Accounting Standards'. Therefore, consolidated financial statements are prepared in accordance with International Accounting Standards.

5. This Standard does not deal with:

(a) methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IAS 22 (revised 1998), business combinations);

(b) accounting for investments in associates (see IAS 28, accounting for investments in associates); and

(c) accounting for investments in joint ventures (see IAS 31, financial reporting of interests in joint ventures).

DEFINITIONS

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

Control (for the purpose of this Standard) is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

A parent is an enterprise that has one or more subsidiaries.

A group is a parent and all its subsidiaries.

Consolidated financial statements are the financial statements of a group presented as those of a single enterprise.

Minority interest is that part of the net results of operations and of net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries, by the parent.

PRESENTATION OF CONSOLIDATED FINANCIAL STATEMENTS

7. ***A parent, other than a parent mentioned in paragraph 8, should present consolidated financial statements.***

8. ***A parent that is a wholly owned subsidiary, or is virtually wholly owned, need not present consolidated financial statements provided, in the case of one that is virtually wholly owned, the parent obtains the approval of the owners of the minority interest. Such a parent should disclose the reasons why consolidated financial statements have not been presented together with the bases on which subsidiaries are accounted for in its separate financial statements. The name and registered office of its parent that publishes consolidated financial statements should also be disclosed.***

9. Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position, results of operations and changes in financial position of the group as a whole. This need is served by consolidated financial statements, which present financial information about the group as that of a single enterprise without regard for the legal boundaries of the separate legal entities.

10. A parent that is itself wholly owned by another enterprise may not always present consolidated financial statements since such statements may not be required by its parent and the needs of other users may be best served by the consolidated financial statements of its parent. In some countries, a parent is also exempted from presenting consolidated financial statements if it is virtually wholly owned by another enterprise and the parent obtains the approval of the owners of the minority interest. Virtually wholly owned is often taken to mean that the parent owns 90 % or more of the voting power.

SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS

11. ***A parent which issues consolidated financial statements should consolidate all subsidiaries, foreign and domestic, other than those referred to in paragraph 13.***

12. The consolidated financial statements include all enterprises that are controlled by the parent, other than those subsidiaries excluded for the reasons set out in paragraph 13. Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than one half of the voting power of an enterprise unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists even when the parent owns one half or less of the voting power of an enterprise when there is ([1]) ([2]).

    (a) power over more than one half of the voting rights by virtue of an agreement with other investors;

    (b) power to govern the financial and operating policies of the enterprise under a statute or an agreement;

    (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body; or

    (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body.

13. ***A subsidiary should be excluded from consolidation when:***

    (a) ***control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or***

    (b) ***it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.***

    Such subsidiaries should be accounted for in accordance with IAS 39, financial instruments: recognition and measurement.

14. A subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other enterprises within the group. Better information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by IAS 14, segment reporting, help to explain the significance of different business activities within the group.

CONSOLIDATION PROCEDURES

15. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single enterprise, the following steps are then taken ([2]):

    (a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see IAS 22 (revised 1998), business combinations, which also describes the treatment of any resultant goodwill);

([1]) See also SIC-12: consolidation — special purpose entities.
([2]) See also SIC-33: consolidation and equity method — potential voting rights and allocation of ownership interests.

(b) minority interests in the net income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and

(c) minority interests in the net assets of consolidated subsidiaries are identified and presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity. Minority interests in the net assets consist of:

(i) the amount at the date of the original combination calculated in accordance with IAS 22 (revised 1998), business combinations; and

(ii) the minority's share of movements in equity since the date of the combination.

16. Taxes payable by either the parent or its subsidiaries on distribution to the parent of the profits retained in subsidiaries are accounted for in accordance with IAS 12, income taxes.

17. ***Intragroup balances and intragroup transactions and resulting unrealised profits should be eliminated in full. Unrealised losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.***

18. Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. Timing differences that arise from the elimination of unrealised profits and losses resulting from intragroup transactions are dealt with in accordance with IAS 12, income taxes.

19. ***When the financial statements used in the consolidation are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case the difference between reporting dates should be no more than three months.***

20. The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are usually drawn up to the same date. When the reporting dates are different, the subsidiary often prepares, for consolidation purposes, statements as at the same date as the group. When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference is no greater than three months. The consistency principle dictates that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.

21. ***Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.***

22. In many cases, if a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

23. The results of operations of a subsidiary are included in the consolidated financial statements as from the date of acquisition, which is the date on which control of the acquired subsidiary is effectively transferred to the buyer, in accordance with IAS 22 (revised 1998), business combinations. The results of operations of a subsidiary disposed of are included in the consolidated income statement until the date of disposal which is the date on which the parent ceases to have control of the subsidiary. The difference between the proceeds

from the disposal of the subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognised in the consolidated income statement as the profit or loss on the disposal of the subsidiary. In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.

24. ***An investment in an enterprise should be accounted for in accordance with IAS 39, financial instruments: recognition and measurement, from the date that it ceases to fall within the definition of a subsidiary and does not become an associate as defined in IAS 28, accounting for investments in associates.***

25. The carrying amount of the investment at the date that it ceases to be a subsidiary is regarded as cost thereafter.

26. ***Minority interests should be presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity. Minority interests in the income of the group should also be separately presented.***

27. The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are charged against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, the majority interest is allocated all such profits until the minority's share of losses previously absorbed by the majority has been recovered.

28. If a subsidiary has outstanding cumulative preferred shares which are held outside the group, the parent computes its share of profits or losses after adjusting for the subsidiary's preferred dividends, whether or not dividends have been declared.

ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES IN A PARENT'S SEPARATE FINANCIAL STATEMENTS

29. ***In a parent's separate financial statements, investments in subsidiaries that are included in the consolidated financial statements should be either:***

(a) ***carried at cost;***

(b) ***accounted for using the equity method as described in IAS 28, accounting for investments in associates; or***

(c) ***accounted for as available-for-sale financial assets as described in IAS 39, financial instruments: recognition and measurement.***

30. ***Investments in subsidiaries that are excluded from consolidated financial statements should be either:***

(a) ***carried at cost;***

(b) ***accounted for using the equity method as described in IAS 28, accounting for investments in associates; or***

(c) ***accounted for as available-for-sale financial assets as described in IAS 39, financial instruments: recognition and measurement.***

31. In many countries separate financial statements are presented by a parent in order to meet legal or other requirements.

DISCLOSURE

32. ***In addition to those disclosures required by paragraphs 8 and 21, the following disclosures should be made:***

(a) ***in consolidated financial statements a listing of significant subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;***

(b) ***in consolidated financial statements, where applicable:***

(i) ***the reasons for not consolidating a subsidiary;***

(ii) ***the nature of the relationship between the parent and a subsidiary of which the parent does not own, directly or indirectly through subsidiaries, more than one half of the voting power;***

(iii) ***the name of an enterprise in which more than one half of the voting power is owned, directly or indirectly through subsidiaries, but which, because of the absence of control, is not a subsidiary; and***

(iv) ***the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and***

(c) ***in the parent's separate financial statements, a description of the method used to account for subsidiaries.***

EFFECTIVE DATE

33. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.***

INTERNATIONAL ACCOUNTING STANDARD IAS 28 (REVISED 2000)

Accounting for investments in associates

IAS 28 was approved by the Board in November 1988.

In November 1994, the text of IAS 28 was reformatted to be presented in the revised format adopted for International Accounting Standards in 1991 (IAS 28 (reformatted 1994)). No substantive changes were made to the original approved text. Certain terminology was changed to bring it into line with IASC practice at the time.

In July 1998, paragraphs 23 and 24 of IAS 28 (reformatted 1994) were revised to be consistent with IAS 36, impairment of assets.

In December 1998, IAS 39, financial instruments: recognition and measurement, amended paragraphs 7, 12 and 14 of IAS 28. The amendments replace references to IAS 25, accounting for investments, by references to IAS 39.

In March 1999, paragraph 26 was amended to replace references to IAS 10, contingencies and events occurring after the balance sheet date, by references to IAS 10 (revised 1999), events after the balance sheet date, and to conform the terminology to that in IAS 37, provisions, contingent liabilities and contingent assets.

In October 2000, paragraph 8 was revised to be consistent with similar paragraphs in other related International Accounting Standards and paragraph 10 was deleted. The changes to paragraph 8 and 10 of IAS 28 become effective when an enterprise applies IAS 39 for the first time.

IAS 28

The following SIC interpretations relate to IAS 28:

— SIC-3: elimination of unrealised profits and losses on transactions with associates, and

— SIC-20: equity accounting method — recognition of losses,

— SIC-33: consolidation and equity method — potential voting rights and allocation of ownership interests.

CONTENTS

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 by an investor for investments in associates.***

2. This Standard supersedes IAS 3, consolidated financial statements, in so far as that Standard deals with accounting for investments in associates.

DEFINITIONS

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

An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

Control (for the purpose of this Standard) is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

The equity method is a method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The income statement reflects the investor's share of the results of operations of the investee.

The cost method is a method of accounting whereby the investment is recorded at cost. The income statement reflects income from the investment only to the extent that the investor receives distributions from accumulated net profits of the investee arising subsequent to the date of acquisition.

Significant influence

4. If an investor holds, directly or indirectly through subsidiaries, 20 % or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case [1]. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 % of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

5. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

   (a) representation on the board of directors or equivalent governing body of the investee;

   (b) participation in policy making processes;

   (c) material transactions between the investor and the investee;

   (d) interchange of managerial personnel; or

   (e) provision of essential technical information.

Equity method

6. Under the equity method, the investment is initially recorded at cost and the carrying amount is increased or decreased to recognise the investor's share of the profits or losses of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for alterations in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the income statement. Such changes include those arising from the revaluation of property, plant, equipment and investments, from foreign exchange translation differences and from the adjustment of differences arising on business combinations [1].

Cost method

7. Under the cost method, an investor records its investment in the investee at cost. The investor recognises income only to the extent that it receives distributions from the accumulated net profits of the investee arising subsequent to the date of acquisition by the investor. Distributions received in excess of such profits are considered a recovery of investment and are recorded as a reduction of the cost of the investment.

[1] See also SIC-33: consolidation and equity method — potential voting rights and allocation of ownership interests.

CONSOLIDATED FINANCIAL STATEMENTS

8. ***An investment in an associate should be accounted for in consolidated financial statements under the equity method except when:***

   (a) ***the investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or***

   (b) ***it operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.***

   Such investments should be accounted for in accordance with IAS 39, financial instruments: recognition and measurement.

9. The recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. As the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of results of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated. As a result, the application of the equity method provides more informative reporting of the net assets and net income of the investor.

10. Deleted

11. ***An investor should discontinue the use of the equity method from the date that:***

   (a) ***it ceases to have significant influence in an associate but retains, either in whole or in part, its investment; or***

   (b) ***the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.***

   The carrying amount of the investment at that date should be regarded as cost thereafter.

SEPARATE FINANCIAL STATEMENTS OF THE INVESTOR

12. ***An investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements and that is not held exclusively with a view to its disposal in the near future should be either:***

   (a) ***carried at cost;***

   (b) ***accounted for using the equity method as described in this Standard; or***

   (c) ***accounted for as an available-for-sale financial asset as described in IAS 39, financial instruments: recognition and measurement.***

13. The preparation of consolidated financial statements does not, in itself, obviate the need for separate financial statements for an investor.

14. ***An investment in an associate that is included in the financial statements of an investor that does not issue consolidated financial statements should be either:***

   (a) ***carried at cost;***

   (b) ***accounted for using the equity method as described in this Standard if the equity method would be appropriate for the associate if the investor issued consolidated financial statements; or***

(c) ***accounted for under IAS 39, financial instruments: recognition and measurement, as an available-for-sale financial asset or a financial asset held for trading based on the definitions in IAS 39.***

15. An investor that has investments in associates may not issue consolidated financial statements because it does not have subsidiaries. It is appropriate that such an investor provides the same information about its investments in associates as those enterprises that issue consolidated financial statements.

APPLICATION OF THE EQUITY METHOD

16. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in IAS 27, consolidated financial statements and Accounting for Investments in Subsidiaries. Furthermore, the broad concepts underlying the consolidation procedures used in the acquisition of a subsidiary are adopted on the acquisition of an investment in an associate ([2]).

17. An investment in an associate is accounted for under the equity method from the date on which it falls within the definition of an associate. On acquisition of the investment any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate is accounted for in accordance with IAS 22, business combinations. Appropriate adjustments to the investor's share of the profits or losses after acquisition are made to account for:

(a) depreciation of the depreciable assets, based on their fair values; and

(b) amortisation of the difference between the cost of the investment and the investor's share of the fair values of the net identifiable assets.

18. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle dictates that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.

19. When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor and the associate that occur between the date of the associate's financial statements and the date of the investor's financial statements.

20. The investor's financial statements are usually prepared using uniform accounting policies for like transactions and events in similar circumstances. In many cases, if an associate uses accounting policies other than those adopted by the investor for like transactions and events in similar circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable for such adjustments to be calculated, that fact is generally disclosed.

21. If an associate has outstanding cumulative preferred shares, held by outside interests, the investor computes its share of profits or losses after adjusting for the preferred dividends, whether or not the dividends have been declared.

([2]) See also SIC-3: elimination of unrealised profits and losses on transactions with associates.

22. If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of an investment, the investor ordinarily discontinues including its share of further losses. The investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses not recognised ([3]).

Impairment losses

23. If there is an indication that an investment in an associate may be impaired, an enterprise applies IAS 36, impairment of assets. In determining the value in use of the investment, an enterprise estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the investee as a whole, including the cash flows from the operations of the investee and the proceeds on the ultimate disposal of the investment; or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result. Any resulting impairment loss for the investment is allocated in accordance with IAS 36. Therefore, it is allocated first to any remaining goodwill (see paragraph 17).

24. The recoverable amount of an investment in an associate is assessed for each individual associate, unless an individual associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the reporting enterprise.

INCOME TAXES

25. Income taxes arising from investments in associates are accounted for in accordance with IAS 12, income taxes.

CONTINGENCIES

26. In accordance with IAS 37, provisions, contingent liabilities and contingent assets, the investor discloses:

(a) its share of the contingent liabilities and capital commitments of an associate for which it is also contingently liable; and

(b) those contingent liabilities that arise because the investor is severally liable for all the liabilities of the associate.

DISCLOSURE

27. ***The following disclosures should be made:***

(a) ***an appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held; and***

(b) ***the methods used to account for such investments.***

28. ***Investments in associates accounted for using the equity method should be classified as long-term assets and disclosed as a separate item in the balance sheet. The investor's share of the profits or losses of such investments should be disclosed as a separate item in the income statement. The investor's share of any extraordinary or prior period items should also be separately disclosed.***

([3]) See also SIC-20: equity accounting method — recognition of losses.

EFFECTIVE DATE

29. ***Except for paragraphs 23 and 24, this International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.***

30. ***Paragraphs 23 and 24 become operative when IAS 36 becomes operative, i.e. for annual financial statements covering periods beginning on or after 1 July 1999, unless IAS 36 is applied for earlier periods.***

31. Paragraphs 23 and 24 of this Standard were approved in July 1998 to supersede paragraphs 23 and 24 of IAS 28, accounting for investments in associates, reformatted in 1994.

INTERNATIONAL ACCOUNTING STANDARD IAS 29 (REFORMATTED 1994)

Financial reporting in hyperinflationary economies

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in April 1989. 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.

The following SIC interpretations relate to IAS 29:

— SIC-19: reporting currency — measurement and presentation of financial statements under IAS 21 and IAS 29,

— SIC-30: reporting currency — translation from measurement currency to presentation currency.

CONTENTS

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 to the primary financial statements, including the consolidated financial statements, of any enterprise that reports in the currency of a hyperinflationary economy.***

2. In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

3. This Standard does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgement when restatement of financial statements in accordance with this Standard becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:

   (a) the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

   (b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

   (c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

   (d) interest rates, wages and prices are linked to a price index; and

   (e) the cumulative inflation rate over three years is approaching, or exceeds, 100 %.

4. It is preferable that all enterprises that report in the currency of the same hyperinflationary economy apply this Standard from the same date. Nevertheless, this Standard applies to the financial statements of any enterprise from the beginning of the reporting period in which it identifies the existence of hyperinflation in the country in whose currency it reports.

THE RESTATEMENT OF FINANCIAL STATEMENTS

5. Prices change over time as the result of various specific or general political, 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 changes in the general level of prices and therefore in the general purchasing power of money.

6. In most countries, primary financial statements are prepared on the historical cost basis of accounting without regard either to changes in the general level of prices or to increases in specific prices of assets held, except to the extent that property, plant and equipment and investments may be revalued. Some enterprises, however, present primary financial statements that are based on a current cost approach that reflects the effects of changes in the specific prices of assets held.

7. In a hyperinflationary economy, financial statements, whether they are based on a historical cost approach or a current cost approach, are useful only if they are expressed in terms of the measuring unit current at the balance sheet date. As a result, this Standard applies to the primary financial statements of enterprises reporting in the currency of a hyperinflationary economy. Presentation of the information required by this Standard as a supplement to unrestated financial statements is not permitted. Furthermore, separate presentation of the financial statements before restatement is discouraged.

8. ***The financial statements of an enterprise that reports in the currency of a hyperinflationary economy, whether they are based on a historical cost approach or a current cost approach, should be stated in terms of the measuring unit current at the balance sheet date. The corresponding figures for the previous period required by IAS 1, presentation of financial statements, and any information in respect of earlier periods should also be stated in terms of the measuring unit current at the balance sheet date.***

9. ***The gain or loss on the net monetary position should be included in net income and disclosed separately.***

10. The restatement of financial statements in accordance with this Standard requires the application of certain procedures as well as judgement. The consistent application of these procedures and judgements from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements.

Historical cost financial statements

Balance sheet

11. Balance sheet amounts not already expressed in terms of the measuring unit current at the balance sheet date are restated by applying a general price index.

12. Monetary items are not restated because they are already expressed in terms of the monetary unit current at the balance sheet date. Monetary items are money held and items to be received or paid in money.

13. Assets and liabilities linked by agreement to changes in prices, such as index linked bonds and loans, are adjusted in accordance with the agreement in order to ascertain the amount outstanding at the balance sheet date. These items are carried at this adjusted amount in the restated balance sheet.

14. All other assets and liabilities are non-monetary. Some non-monetary items are carried at amounts current at the balance sheet date, such as net realisable value and market value, so they are not restated. All other non-monetary assets and liabilities are restated.

15. Most non-monetary items are carried at cost or cost less depreciation; hence they are expressed at amounts current at their date of acquisition. The restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the balance sheet date. Hence, property, plant and equipment, investments, inventories of raw materials and merchandise, goodwill, patents, trade marks and similar assets are restated from the dates of their purchase. Inventories of partly-finished and finished goods are restated from the dates on which the costs of purchase and of conversion were incurred.

16. Detailed records of the acquisition dates of items of property, plant and equipment may not be available or capable of estimation. In these rare circumstances, it may be necessary, in the first period of application of this Standard, to use an independent professional assessment of the value of the items as the basis for their restatement.

17. A general price index may not be available for the periods for which the restatement of property, plant and equipment is required by this Standard. In these rare circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the reporting currency and a relatively stable foreign currency.

18. Some non-monetary items are carried at amounts current at dates other than that of acquisition or that of the balance sheet, for example property, plant and equipment that has been revalued at some earlier date. In these cases, the carrying amounts are restated from the date of the revaluation.

19. The restated amount of a non-monetary item is reduced, in accordance with appropriate International Accounting Standards, when it exceeds the amount recoverable from the item's future use (including sale or other disposal). Hence, in such cases, restated amounts of property, plant and equipment, goodwill, patents and trade marks are reduced to recoverable amount, restated amounts of inventories are reduced to net realisable value and restated amounts of current investments are reduced to market value.

20. An investee that is accounted for under the equity method may report in the currency of a hyperinflationary economy. The balance sheet and income statement of such an investee are restated in accordance with this Standard in order to calculate the investor's share of its net assets and results of operations. Where the restated financial statements of the investee are expressed in a foreign currency they are translated at closing rates.

21. The impact of inflation is usually recognised in borrowing costs. It is not appropriate both to restate the capital expenditure financed by borrowing and to capitalise that part of the borrowing costs that compensates for the inflation during the same period. This part of the borrowing costs is recognised as an expense in the period in which the costs are incurred.

22. An enterprise may acquire assets under an arrangement that permits it to defer payment without incurring an explicit interest charge. Where it is impracticable to impute the amount of interest, such assets are restated from the payment date and not the date of purchase.

23. IAS 21, the effects of changes in foreign exchange rates, permits an enterprise to include foreign exchange differences on borrowings in the carrying amount of assets following a severe and recent devaluation. Such a practice is not appropriate for an enterprise reporting in the currency of a hyperinflationary economy when the carrying amount of the asset is restated from the date of its acquisition.

24. At the beginning of the first period of application of this Standard, the components of owners' equity, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates the components were contributed or otherwise arose. Any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all the other amounts in the restated balance sheet.

25. At the end of the first period and in subsequent periods, all components of owners' equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The movements for the period in owners' equity are disclosed in accordance with IAS 1, presentation of financial statements.

Income statement

26. This Standard requires that all items in the income statement are expressed in terms of the measuring unit current at the balance sheet date. Therefore all amounts need to be restated by applying the change in the general price index from the dates when the items of income and expenses were initially recorded in the financial statements.

Gain or loss on net monetary position

27. In a period of inflation, an enterprise holding an excess of monetary assets over monetary liabilities loses purchasing power and an enterprise with an excess of monetary liabilities over monetary assets gains purchasing power to the extent the assets and liabilities are not linked to a price level. This gain or loss on the net monetary position may be derived as the difference resulting from the restatement of non-monetary assets, owners' equity and income statement items and the adjustment of index linked assets and liabilities. The gain or loss may be estimated by applying the change in a general price index to the weighted average for the period of the difference between monetary assets and monetary liabilities.

28. The gain or loss on the net monetary position is included in net income. The adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 13 is offset against the gain or loss on net monetary position. Other income statement items, such as interest income and expense, and foreign exchange differences related to invested or borrowed funds, are also associated with the net monetary position. Although such items are separately disclosed, it may be helpful if they are presented together with the gain or loss on net monetary position in the income statement.

Current cost financial statements

Balance sheet

29. Items stated at current cost are not restated because they are already expressed in terms of the measuring unit current at the balance sheet date. Other items in the balance sheet are restated in accordance with paragraphs 11 to 25.

Income statement

30. The current cost income statement, before restatement, generally reports costs current at the time at which the underlying transactions or events occurred. Cost of sales and depreciation are recorded at current costs at the time of consumption; sales and other expenses are recorded at their money amounts when they occurred. Therefore all amounts need to be restated into the measuring unit current at the balance sheet date by applying a general price index.

Gain or loss on net monetary position

31. The gain or loss on the net monetary position is accounted for in accordance with paragraphs 27 and 28. The current cost income statement may, however, already include an adjustment reflecting the effects of changing prices on monetary items in accordance with paragraph 16 of IAS 15, information reflecting the effects of changing prices. Such an adjustment is part of the gain or loss on net monetary position.

Taxes

32. The restatement of financial statements in accordance with this Standard may give rise to differences between taxable income and accounting income. These differences are accounted for in accordance with IAS 12, income taxes.

Cash flow statement

33. This Standard requires that all items in the cash flow statement are expressed in terms of the measuring unit current at the balance sheet date.

Corresponding figures

34. Corresponding figures for the previous reporting period, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period.

Consolidated financial statements

35. A parent that reports in the currency of a hyperinflationary economy may have subsidiaries that also report in the currencies of hyperinflationary economies. The financial statements of any such subsidiary need to be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its parent. Where such a subsidiary is a foreign subsidiary, its restated financial statements are translated at closing rates. The financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21, the effects of changes in foreign exchange rates.

36. If financial statements with different reporting dates are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statements.

Selection and use of the general price index

37. The restatement of financial statements in accordance with this Standard requires the use of a general price index that reflects changes in general purchasing power. It is preferable that all enterprises that report in the currency of the same economy use the same index.

ECONOMIES CEASING TO BE HYPERINFLATIONARY

38. ***When an economy ceases to be hyperinflationary and an enterprise discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it should treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.***

DISCLOSURES

39. ***The following disclosures should be made*** [1]***:***

   (a) ***the fact that the financial statements and the corresponding figures for previous periods have been restated for the changes in the general purchasing power of the reporting currency and, as a result, are stated in terms of the measuring unit current at the balance sheet date;***

   (b) ***whether the financial statements are based on a historical cost approach or a current cost approach; and***

   (c) ***the identity and level of the price index at the balance sheet date and the movement in the index during the current and the previous reporting period.***

40. The disclosures required by this Standard are needed to make clear the basis of dealing with the effects of inflation in the financial statements. They are also intended to provide other information necessary to understand that basis and the resulting amounts.

EFFECTIVE DATE

41. ***This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.***

INTERNATIONAL ACCOUNTING STANDARD IAS 30 (REFORMATTED 1994)

Disclosures in the financial statements of banks and similar financial institutions

This reformatted International Accounting Standard supersedes the Standard originally approved by the Board in June 1990. 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 1998, paragraphs 24 and 25 of IAS 30 were amended. The amendments replace references to IAS 25, accounting for investments, by references to IAS 39, financial instruments: recognition and measurement.

In 1999, paragraphs 26, 27, 50 and 51 of IAS 30 were amended. These amendments replace references to IAS 10, contingencies and events occurring after the balance sheet date, by references to IAS 37, provisions, contingent liabilities and contingent assets, and conform the terminology used to that in IAS 37.

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[1] See also SIC-30: reporting currency — translation from measurement currency to presentation currency.

CONTENTS

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 the financial statements of banks and similar financial institutions (subsequently referred to as banks).***

2. For the purposes of this Standard, the term 'bank' includes all financial institutions, one of whose principal activities is to take deposits and borrow with the objective of lending and investing and which are within the scope of banking or similar legislation. The Standard is relevant to such enterprises whether or not they have the word 'bank' in their name.

3. Banks represent a significant and influential sector of business worldwide. Most individuals and organisations make use of banks, either as depositors or borrowers. Banks play a major role in maintaining confidence in the monetary system through their close relationship with regulatory authorities and governments and the regulations imposed on them by those governments. Hence there is considerable and widespread interest in the well-being of banks, and in particular their solvency and liquidity and the relative degree of risk that attaches to the different types of their business. The operations, and thus the accounting and reporting requirements, of banks are different from those of other commercial enterprises. This Standard recognises their special needs. It also encourages the presentation of a commentary on the financial statements which deals with such matters as the management and control of liquidity and risk.

4. This Standard supplements other International Accounting Standards which also apply to banks unless they are specifically exempted in a Standard.

5. This Standard applies to the separate financial statements and the consolidated financial statements of a bank. Where a group undertakes banking operations, this Standard is applicable in respect of those operations on a consolidated basis.

BACKGROUND

6. The users of the financial statements of a bank need relevant, reliable and comparable information which assists them in evaluating the financial position and performance of the bank and which is useful to them in making economic decisions. They also need information which gives them a better understanding of the special characteristics of the operations of a bank. Users need such information even though a bank is subject to supervision and provides the regulatory authorities with information that is not always available to the public. Therefore disclosures in the financial statements of a bank need to be sufficiently comprehensive to meet the needs of users, within the constraint of what it is reasonable to require of management.

7. The users of the financial statements of a bank are interested in its liquidity and solvency and the risks related to the assets and liabilities recognised on its balance sheet and to its off balance sheet items. Liquidity refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments as they fall due. Solvency refers to the excess of assets over liabilities and, hence, to the adequacy of the bank's capital. A bank is exposed to liquidity risk and to risks arising from currency fluctuations, interest rate movements, changes in market prices and from counterparty failure. These risks may be reflected in the financial statements, but users obtain a better understanding if management provides a commentary on the financial statements which describes the way it manages and controls the risks associated with the operations of the bank.

ACCOUNTING POLICIES

8. Banks use differing methods for the recognition and measurement of items in their financial statements. While harmonisation of these methods is desirable, it is beyond the scope of this Standard. In order to comply with IAS 1, presentation of financial statements, and thereby enable users to understand the basis on which the financial statements of a bank are prepared, accounting policies dealing with the following items may need to be disclosed:

   (a) the recognition of the principal types of income (see paragraphs 10 and 11);

   (b) the valuation of investment and dealing securities (see paragraphs 24 and 25);

   (c) the distinction between those transactions and other events that result in the recognition of assets and liabilities on the balance sheet and those transactions and other events that only give rise to contingencies and commitments (see paragraphs 26 to 29);

   (d) the basis for the determination of losses on loans and advances and for writing off uncollectable loans and advances (see paragraphs 43 to 49); and

   (e) the basis for the determination of charges for general banking risks and the accounting treatment of such charges (see paragraphs 50 to 52).

   Some of these topics are the subject of existing International Accounting Standards while others may be dealt with at a later date.

INCOME STATEMENT

9. ***A bank should present an income statement which groups income and expenses by nature and discloses the amounts of the principal types of income and expenses.***

10. ***In addition to the requirements of other International Accounting Standards, the disclosures in the income statement or the notes to the financial statements should include, but are not limited to, the following items of income and expenses:***

— ***interest and similar income,***

— ***interest expense and similar charges,***

— ***dividend income,***

— ***fee and commission income,***

— ***fee and commission expense,***

— ***gains less losses arising from dealing securities,***

— ***gains less losses arising from investment securities,***

— ***gains less losses arising from dealing in foreign currencies,***

— ***other operating income,***

— ***losses on loans and advances,***

— ***general administrative expenses, and***

— ***other operating expenses.***

11. The principal types of income arising from the operations of a bank include interest, fees for services, commissions and dealing results. Each type of income is separately disclosed in order that users can assess the performance of a bank. Such disclosures are in addition to those of the source of income required by IAS 14, segment reporting.

12. The principal types of expenses arising from the operations of a bank include interest, commissions, losses on loans and advances, charges relating to the reduction in the carrying amount of investments and general administrative expenses. Each type of expense is separately disclosed in order that users can assess the performance of a bank.

13. ***Income and expense items should not be offset except for those relating to hedges and to assets and liabilities which have been offset in accordance with paragraph 23.***

14. Offsetting in cases other than those relating to hedges and to assets and liabilities which have been offset as described in paragraph 23 prevents users from assessing the performance of the separate activities of a bank and the return that it obtains on particular classes of assets.

15. Gains and losses arising from each of the following are normally reported on a net basis:

(a) disposals and changes in the carrying amount of dealing securities;

(b) disposals of investment securities; and

(c) dealings in foreign currencies.

16. Interest income and interest expense are disclosed separately in order to give a better understanding of the composition of, and reasons for changes in, net interest.

17. Net interest is a product of both interest rates and the amounts of borrowing and lending. It is desirable for management to provide a commentary about average interest rates, average interest earning assets and average interest-bearing liabilities for the period. In some countries, governments provide assistance to banks by making deposits and other credit facilities available at interest rates which are substantially below market rates. In these cases, management's commentary often discloses the extent of these deposits and facilities and their effect on net income.

BALANCE SHEET

18. ***A bank should present a balance sheet that groups assets and liabilities by nature and lists them in an order that reflects their relative liquidity.***

19. ***In addition to the requirements of other International Accounting Standards, the disclosures in the balance sheet or the notes to the financial statements should include, but are not limited to, the following assets and liabilities:***

Assets:

— ***cash and balances with the central bank,***

— ***treasury bills and other bills eligible for rediscounting with the central bank,***

— ***government and other securities held for dealing purposes,***

— ***placements with, and loans and advances to, other banks,***

— ***other money market placements,***

— ***loans and advances to customers, and***

— ***investment securities.***

Liabilities:

— ***deposits from other banks,***

— ***other money market deposits,***

— ***amounts owed to other depositors,***

— ***certificates of deposits,***

— ***promissory notes and other liabilities evidenced by paper, and***

— ***other borrowed funds.***

20. The most useful approach to the classification of the assets and liabilities of a bank is to group them by their nature and list them in the approximate order of their liquidity; this may equate broadly to their maturities. Current and non-current items are not presented separately because most assets and liabilities of a bank can be realised or settled in the near future.

21. The distinction between balances with other banks and those with other parts of the money market and from other depositors is relevant information because it gives an understanding of a bank's relations with, and dependence on, other banks and the money market. Hence, a bank discloses separately:

(a) balances with the central bank;

(b) placements with other banks;

(c) other money market placements;

(d) deposits from other banks;

(e) other money market deposits; and

(f) other deposits.

22. A bank generally does not know the holders of its certificates of deposit because they are usually traded on an open market. Hence, a bank discloses separately deposits that have been obtained through the issue of its own certificates of deposit or other negotiable paper.

23. ***The amount at which any asset or liability is stated in the balance sheet should not be offset by the deduction of another liability or asset unless a legal right of set-off exists and the offsetting represents the expectation as to the realisation or settlement of the asset or liability.***

24. ***A bank should disclose the fair values of each class of its financial assets and liabilities as required by IAS 32, financial instruments: disclosure and presentation, and IAS 39, financial instruments: recognition and measurement.***

25. IAS 39 provides for four classifications of financial assets: loans and receivables originated by the enterprise, held-to-maturity investments, financial assets held for trading, and available-for-sale financial assets. A bank will disclose the fair values of its financial assets for these four classifications, as a minimum.

CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS

26. ***A bank should disclose the following contingent liabilities and commitments:***

    (a) ***the nature and amount of commitments to extend credit that are irrevocable because they cannot be withdrawn at the discretion of the bank without the risk of incurring significant penalty or expense; and***

    (b) ***the nature and amount of contingent liabilities and commitments arising from off balance sheet items including those relating to:***

        (i) ***direct credit substitutes including general guarantees of indebtedness, bank acceptance guarantees and standby letters of credit serving as financial guarantees for loans and securities;***

        (ii) ***certain transaction-related contingent liabilities including performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions;***

        (iii) ***short-term self-liquidating trade-related contingent liabilities arising from the movement of goods, such as documentary credits where the underlying shipment is used as security;***

        (iv) ***those sale and repurchase agreements not recognised in the balance sheet;***

        (v) ***interest and foreign exchange rate related items including swaps, options and futures; and***

        (vi) ***other commitments, note issuance facilities and revolving underwriting facilities.***

27. IAS 37, provisions, contingent liabilities and contingent assets, deals generally with accounting for, and disclosure of, contingent liabilities. The Standard is of particular relevance to banks because banks often become engaged in many types of contingent liabilities and commitments, some revocable and others irrevocable, which are frequently significant in amount and substantially larger than those of other commercial enterprises.

28. Many banks also enter into transactions that are presently not recognised as assets or liabilities in the balance sheet but which give rise to contingencies and commitments. Such off balance sheet items often represent an important part of the business of a bank and may have a significant bearing on the level of risk to which the bank is exposed. These items may add to, or reduce, other risks, for example by hedging assets or liabilities on the balance sheet. Off balance sheet items may arise from transactions carried out on behalf of customers or from the bank's own trading position.

29. The users of the financial statements need to know about the contingencies and irrevocable commitments of a bank because of the demands they may put on its liquidity and solvency and the inherent possibility of potential losses. Users also require adequate information about the nature and amount of off balance sheet transactions undertaken by a bank.

MATURITIES OF ASSETS AND LIABILITIES

30. ***A bank should disclose an analysis of assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.***

31. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of a bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability but can also increase the risk of losses.

32. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of a bank and its exposure to changes in interest rates and exchange rates. In order to provide information that is relevant for the assessment of its liquidity, a bank discloses, as a minimum, an analysis of assets and liabilities into relevant maturity groupings.

33. The maturity groupings applied to individual assets and liabilities differ between banks and in their appropriateness to particular assets and liabilities. Examples of periods used include the following:

(a) up to 1 month;

(b) from 1 month to 3 months;

(c) from 3 months to 1 year;

(d) from 1 year to 5 years; and

(e) from 5 years and over.

Frequently the periods are combined, for example, in the case of loans and advances, by grouping those under one year and those over one year. When repayment is spread over a period of time, each instalment is allocated to the period in which it is contractually agreed or expected to be paid or received.

34. It is essential that the maturity periods adopted by a bank are the same for assets and liabilities. This makes clear the extent to which the maturities are matched and the consequent dependence of the bank on other sources of liquidity.

35. Maturities could be expressed in terms of:

(a) the remaining period to the repayment date;

(b) the original period to the repayment date; or

(c) the remaining period to the next date at which interest rates may be changed.

The analysis of assets and liabilities by their remaining periods to the repayment dates provides the best basis to evaluate the liquidity of a bank. A bank may also disclose repayment maturities based on the original period to the repayment date in order to provide information about its funding and business strategy. In addition, a bank may disclose maturity groupings based on the remaining period to the next date at which interest rates may be changed in order to demonstrate its exposure to interest rate risks. Management may also provide, in its commentary on the financial statements, information about interest rate exposure and about the way it manages and controls such exposures.

36. In many countries, deposits made with a bank may be withdrawn on demand and advances given by a bank may be repayable on demand. However, in practice, these deposits and advances are often maintained for long periods without withdrawal or repayment; hence, the effective date of repayment is later than the contractual date. Nevertheless, a bank discloses an analysis expressed in terms of contractual maturities even though the contractual repayment period is often not the effective period because contractual dates reflect the liquidity risks attaching to the bank's assets and liabilities.

37. Some assets of a bank do not have a contractual maturity date. The period in which these assets are assumed to mature is usually taken as the expected date on which the assets will be realised.

38. The users' evaluation of the liquidity of a bank from its disclosure of maturity groupings is made in the context of local banking practices, including the availability of funds to banks. In some countries, short-term funds are available, in the normal course of business, from the money market or, in an emergency, from the central bank. In other countries, this is not the case.

39. In order to provide users with a full understanding of the maturity groupings, the disclosures in the financial statements may need to be supplemented by information as to the likelihood of repayment within the remaining period. Hence, management may provide, in its commentary on the financial statements, information about the effective periods and about the way it manages and controls the risks and exposures associated with different maturity and interest rate profiles.

CONCENTRATIONS OF ASSETS, LIABILITIES AND OFF BALANCE SHEET ITEMS

40. ***A bank should disclose any significant concentrations of its assets, liabilities and off balance sheet items. Such disclosures should be made in terms of geographical areas, customer or industry groups or other concentrations of risk. A bank should also disclose the amount of significant net foreign currency exposures.***

41. A bank discloses significant concentrations in the distribution of its assets and in the source of its liabilities because it is a useful indication of the potential risks inherent in the realisation of the assets and the funds available to the bank. Such disclosures are made in terms of geographical areas, customer or industry groups or other concentrations of risk which are appropriate in the circumstances of the bank. A similar analysis and explanation of off balance sheet items is also important. Geographical areas may comprise individual countries, groups of countries or regions within a country; customer disclosures may deal with sectors such as governments, public authorities, and commercial and business enterprises. Such disclosures are made in addition to any segment information required by IAS 14, segment reporting.

42. The disclosure of significant net foreign currency exposures is also a useful indication of the risk of losses arising from changes in exchange rates.

LOSSES ON LOANS AND ADVANCES

43. ***A bank should disclose the following:***

(a) ***the accounting policy which describes the basis on which uncollectable loans and advances are recognised as an expense and written off;***

(b) ***details of the movements in the provision for losses on loans and advances during the period. It should disclose separately the amount recognised as an expense in the period for losses on uncollectable loans and advances, the amount charged in the period for loans and advances written off and the amount credited in the period for loans and advances previously written off that have been recovered;***

(c) ***the aggregate amount of the provision for losses on loans and advances at the balance sheet date; and***

(d) ***the aggregate amount included in the balance sheet for loans and advances on which interest is not being accrued and the basis used to determine the carrying amount of such loans and advances.***

44. ***Any amounts set aside in respect of losses on loans and advances in addition to those losses that have been specifically identified or potential losses which experience indicates are present in the portfolio of loans and advances should be accounted for as appropriations of retained earnings. Any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of net profit or loss for the period.***

45. It is inevitable that in the ordinary course of business, banks suffer losses on loans, advances and other credit facilities as a result of their becoming partly or wholly uncollectable. The amount of losses which have been specifically identified is recognised as an expense and deducted from the carrying amount of the appropriate category of loans and advances as a provision for losses on loans and advances. The amount of potential losses not specifically identified but which experience indicates are present in the portfolio of loans and advances is also recognised as an expense and deducted from the total carrying amount of loans and advances as a provision for losses on loans and advances. The assessment of these losses depends on the judgement of management; it is essential, however, that management applies its assessments in a consistent manner from period to period.

46. Local circumstances or legislation may require or allow a bank to set aside amounts for losses on loans and advances in addition to those losses which have been specifically identified and those potential losses which experience indicates are present in the portfolio of loans and advances. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining net profit or loss for the period. Similarly, any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of net profit or loss for the period.

47. Users of the financial statements of a bank need to know the impact that losses on loans and advances have had on the financial position and performance of the bank; this helps them judge the effectiveness with which the bank has employed its resources. Therefore a bank discloses the aggregate amount of the provision for losses on loans and advances at the balance sheet date and the movements in the provision during the period. The movements in the provision, including the amounts previously written off that have been recovered during the period, are shown separately.

48. A bank may decide not to accrue interest on a loan or advance, for example when the borrower is more than a particular period in arrears with respect to the payment of interest or principal. A bank discloses the aggregate amount of loans and advances at the balance sheet date on which interest is not being accrued and the basis used to determine the carrying amount of such loans and advances. It is also desirable that a bank discloses whether it recognises interest income on such loans and advances and the impact which the non-accrual of interest has on its income statement.

49. When loans and advances cannot be recovered, they are written off and charged against the provision for losses. In some cases, they are not written off until all the necessary legal procedures have been completed and the amount of the loss is finally determined. In other cases, they are written off earlier, for example when the borrower has not paid any interest or repaid any principal that was due in a specified period. As the time at which uncollectable loans and advances are written off differs, the gross amount of loans and advances and of the provisions for losses may vary considerably in similar circumstances. As a result, a bank discloses its policy for writing off uncollectable loans and advances.

GENERAL BANKING RISKS

50. ***Any amounts set aside for general banking risks, including future losses and other unforeseeable risks or contingencies should be separately disclosed as appropriations of retained earnings. Any credits resulting from the reduction of such amounts result in an increase in retained earnings and should not be included in the determination of net profit or loss for the period.***

51. Local circumstances or legislation may require or allow a bank to set aside amounts for general banking risks, including future losses or other unforeseeable risks, in addition to the charges for losses on loans and advances determined in accordance with paragraph 45. A bank may also be required or allowed to set aside amounts for contingencies. Such amounts for general banking risks and contingencies do not qualify for recognition as provisions under IAS 37, provisions, contingent liabilities and contingent assets. Therefore, a bank recognises such amounts as appropriations of retained earnings. This is necessary to avoid the overstatement of liabilities, understatement of assets, undisclosed accruals and provisions and the opportunity to distort net income and equity.

52. The income statement cannot present relevant and reliable information about the performance of a bank if net profit or loss for the period includes the effects of undisclosed amounts set aside for general banking risks or additional contingencies, or undisclosed credits resulting from the reversal of such amounts. Similarly, the balance sheet cannot provide relevant and reliable information about the financial position of a bank if the balance sheet includes overstated liabilities, understated assets or undisclosed accruals and provisions.

ASSETS PLEDGED AS SECURITY

53. ***A bank should disclose the aggregate amount of secured liabilities and the nature and carrying amount of the assets pledged as security.***

54. In some countries, banks are required, either by law or national custom, to pledge assets as security to support certain deposits and other liabilities. The amounts involved are often substantial and so may have a significant impact on the assessment of the financial position of a bank.

TRUST ACTIVITIES

55. Banks commonly act as trustees and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. Provided the trustee or similar relationship is legally supported, these assets are not assets of the bank and, therefore, are not included in its balance sheet. If the bank is engaged in significant trust activities, disclosure of that fact and an indication of the extent of those activities is made in its financial statements because of the potential liability if it fails in its fiduciary duties. For this purpose, trust activities do not encompass safe custody functions.

RELATED PARTY TRANSACTIONS

56. IAS 24, related party disclosures, deals generally with the disclosures of related party relationships and transactions between a reporting enterprise and its related parties. In some countries, the law or regulatory authorities prevent or restrict banks entering into transactions with related parties whereas in others such transactions are permitted. IAS 24, is of particular relevance in the presentation of the financial statements of a bank in a country that permits such transactions.

57. Certain transactions between related parties may be effected on different terms from those with unrelated parties. For example, a bank may advance a larger sum or charge lower interest rates to a related party than it would in otherwise identical circumstances to an unrelated party; advances or deposits may be moved between related parties more quickly and with less formality than is possible when unrelated parties are involved. Even when related party transactions arise in the ordinary course of a bank's business, information about such transactions is relevant to the needs of users and its disclosure is required by IAS 24.

58. When a bank has entered into transactions with related parties, it is appropriate to disclose the nature of the related party relationship, the types of transactions, and the elements of transactions necessary for an understanding of the financial statements of the bank. The elements that would normally be disclosed to conform with IAS 24 include a bank's lending policy to related parties and, in respect of related party transactions, the amount included in or the proportion of:

(a) each of loans and advances, deposits and acceptances and promissory notes; disclosures may include the aggregate amounts outstanding at the beginning and end of the period, as well as advances, deposits, repayments and other changes during the period;

(b) each of the principal types of income, interest expense and commissions paid;

(c) the amount of the expense recognised in the period for losses on loans and advances and the amount of the provision at the balance sheet date; and

(d) irrevocable commitments and contingencies and commitments arising from off balance sheet items.

EFFECTIVE DATE

59. ***This International Accounting Standard becomes operative for the financial statements of banks covering periods beginning on or after 1 January 1991.***

INTERNATIONAL ACCOUNTING STANDARD IAS 31 (REVISED 2000)

Financial reporting of interests in joint ventures

IAS 31 was approved by the Board in November 1990.

In November 1994, the text of IAS 31 was reformatted to be presented in the revised format adopted for International Accounting Standards in 1991. No substantive changes were made to the original text. Certain terminology was changed to be in line with IASC practice at the time.

In July 1998, to be consistent with IAS 36, impairment of assets, paragraphs 39 and 40 were revised and a new paragraph 41 was added.

In December 1998, paragraphs 35 and 42 of IAS 31 were amended to replace references to IAS 25, accounting for investments, by references to IAS 39, financial instruments: recognition and measurement.

In March 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 45 to be consistent with the terminology in IAS 37, provisions, contingent liabilities and contingent assets.

In October 2000, paragraph 35 was revised to be consistent with similar paragraphs in other related International Accounting Standards. The change to paragraph 35 becomes effective when an enterprise applies IAS 39 for the first time.

One SIC interpretation relates to IAS 31:

— SIC-13: jointly controlled entities — non-monetary contributions by venturers.

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